

Transformation In Indian Banks Through Corporate Governance-Emerging Challenges & Strategies For A New Gateway

**Dr. R.K.Uppal*

***Poonam Rani*

INTRODUCTION

Strengthening the financial sector and improving the functioning of financial markets have been the core objective of the financial sector reforms in India. The significant transformation of the financial system in the country is clearly evident from the changes that have occurred in the financial markets, institutions and products. In 1990, the country witnessed an economic crisis leading to a fast decline in the GDP, a high rate of inflation, adverse BOPs due to a widening gap in the current account deficit and a decline in the foreign exchange reserves. The country had to borrow resources from foreign central banks and other foreign government agencies against the pledge of gold so as to avoid a default on international indebtedness. There were some banking sector deficiencies ahead of the economy, which were adversely affecting the economic growth of our country such as low productivity and profitability, public sector banks were incurring losses year after year, giving poor customer service, using outdated work technology etc. Keeping in mind all these distortions in the economic, financial and banking sectors, the government of India and the RBI thought it was necessary to introduce reforms in the financial and banking sector, so as to promote rapid economic growth and development with stability through the process of globalization, liberalization and privatization in the financial system to make the financial system more competitive and integrated with the world economy through internationalization of financial markets in the world.

BANK TRANSFORMATION

The term transformation in Indian Banking Industry relates to the intermediately stage when the industry is passing from the earlier social banking era to the newly conceived technology based customer - centric and competitive banking. The activities of banks have grown in multi-directional as well as in multi-dimensional manners. During transformation, all known parameters of the earlier regime continuously change like:

- | | |
|------------------------------|---------------------------------|
| (i) Capital Restructuring | (ii) Financial Re-engineering |
| (iii) Information Technology | (iv) Human Resource Development |

Table 1 : Bank Transformation/ Stages Of Transformation In Indian Banks

Stage of Transformation	Structure of Banks	Objectives of the Banks	Nature of Technology Used
Pre- Nationalization of Banks (before 1969)	Private Control of Banks	Higher Profitability	Manual Work
Post- Nationalization of Banks (1969 - 90)	Control of Govt.	Social banking	Limited Computerization
Economic Reforms (1991- 2000)	- Entry of Foreign and NPSBs - Social Banking to IT Based banks	- Higher Profitability - Fierce Competition	E - Banks
Current Stage	Implementation of various committees' reports	- New Products and Services - Entry in Insurance - CRM with IT	- Maximum use of IT - Mobile ATMs

**Principal Investigator, UGC Sponsored Major Research Project and Head, Department of Economics, D.A.V. College, Malout, Punjab. Email : rkuppal_mlt@yahoo.com*

***Project Fellow, UGC Sponsored Major Research Project, D.A.V College, Malout, Punjab*

Table 2: Process Of Transformation

Parameters of Transformation	Process	Implications
Structure Business Re-engineering Human Resource Development Work Culture Information Technology System, Process and Procedures Ethos/Philosophy	IT as the catalyst of Transformation	- Improved and efficient structure - Improved vision for business -Productivity, profitability and efficiency has increased - Innovations are taking place -International outlook - Inspire employees - More ethical work culture - Vision for global economy

“Corporate Governance has never been more important than now. It is not only the business of an individual bank or entity, but all of us. 5 or 10 years down the line, we would not be able to operate unless we have corporate governance of best standards.” (Dr. Bimal Jalan).

Corporate governance is a buzzword today. Everyone in the corporate sector is speaking about it. The interest in good corporate governance is because of the emergence of competition, external as well as internal, on the business horizon. Defined in simple terms, corporate governance is about ensuring that a business performs well through the adoption of fair and ethical principles and that investors receive a reasonable return. The governance framework provides the overall direction to management and ensures accountability to shareholders and other stakeholders. At the centre of this system is the Board of Directors of the organization, who are charged with the responsibility of ensuring the long term viability of the company through oversight of the management. In addition, in many countries, boards have a fiduciary responsibility for compliance with laws and regulations including accounting and financial reporting. Therefore, the Board of Directors will have to balance the interest of the shareholders like employees, customers, government, regulators etc. Notwithstanding the apparent conflict of interests, the overriding goal of all the stakeholders including the shareholders is to achieve business excellence. As such, each of the stakeholders has a responsibility. Unless the owners, shareholders, employees, customers, suppliers and the regulators adopt fair and ethical means, realizing the benefits of good governance will not be possible. Therefore, 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. Good corporate governance of banks is the sine qua non of a sound banking system. Best practices of corporate governance in banks are of great value to a number of stakeholder's viz. depositors, creditors, customers, shareholders, employees and society at large. Corporate governance is, therefore, about ensuring co-operative relevance and performance by connecting members, management and the employees to the policy, strategy and decision making processes.

CORPORATE GOVERNANCE

Corporate Governance is a very broad concept. It is a system of running a business organization on certain ethical principles. There cannot be a universally accepted definition of the term Corporate Governance. According to the Noble Laureate Milton Friedman, *“Corporate Governance is to conduct the business in accordance with owner or shareholders desires, which generally will be to make as much money as possible, while conforming to the basic rules of the society embodied in law and local customs”*. This definition is narrow in scope as it gives more importance to the owners stake. Over a period of time, with fast developments in the world, the scope of the corporate governance has widened. It now encompasses the interest of not only the owners but also many stakeholders.

ROLE OF COMPETITION IN PRODUCT MARKET AND TAKEOVERS

Instead of focusing on the legal mechanisms via which equity and debt holders seek to exert corporate control, Alchian (1950) stresses that market competition forces firms to minimize costs, including the adoption of corporate

control mechanisms that minimize the cost of raising external finance. Nevertheless, in their extensive survey, Shleifer and Vishny (1997, p. 738) conclude that although “*product market competition is probably the most powerful force towards economic efficiency in the world, we are skeptical that it alone can solve the problem of corporate governance.*” A second form of competition may also address governance problems: Takeovers. Poorly performing firms may receive a tender offer and the shareholders can decide whether to accept the offer. If they accept the offer, the acquiring firm may fire the managers of the target firm. A fluid takeover market would thus create incentives for managers to act in the best interests of the shareholders to avoid being fired in a takeover (Jensen, 1988, 1993). Evidence, however, suggests that given the power of managers and the scarcity of liquid capital markets, takeovers are essentially nonexistent as a corporate governance mechanism outside of the U.S. and the U.K. (Shleifer and Vishny, 1997). The history of corporate governance can be traced to the Watergate Scandal in USA and the enactment of Foreign and Corrupt Practices Act of 1977 that contained specific provisions regarding the establishment, maintenance and review of systems of internal control. Later, following a series of high profile business failures in the US, the Treadway Commission was constituted with the mandate to identify the main causes of misrepresentation in financial reports and ways to reduce such incidence. The report while recognizing the inadequacies of the then legal infrastructure to deal with corporate failures due to poor business practices, highlighted the need for a proper control environment, independent audit committees and an objective internal audit function. Then followed the Cadbury Committee report, a seminal work on this topic which has also become the model for corporate governance and has helped to raise governance standards and increase the level of confidence in financial reporting and auditing by clarifying the respective responsibilities and obligations of the relevant entities. This code of best practices focused on the control and reporting functions of the board and the role of auditors. The Combined Code of the London Stock Exchange, The Blue Ribbon Committee of the US, the OECD's Code of 1998, the joint efforts of the World Bank and the OECD to develop benchmarks in corporate governance that qualify as best practices under the standards and codes identified by the Financial Stability Forum are all reflections of the debate that has dominated the last twenty years.

In the context of the above, the following are the board objectives on which corporate governance can be measured:

- 1) Suggested Model Code Of Best Practices.;
- 2) Preferred Internal System.;
- 3) Recommended Disclosure Requirements.;
- 4) Board Member's Role. ;
- 5) Independent Director.;
- 6) Key Information To The Board/Committee;
- 7) Committees Of Board. ;
- 8) Policies To Be Established By The Board.;
- 9) Monitoring Performance.

In order to effectively monitor bank's performance in critical areas, the board should form the following committees:

✿ **COMMITTEE OF BOARD/CREDIT COMMITTEE**

1. The committee should comprise of five members, majority of whom should be non-executive directors.
2. It is authorized to act on behalf of the full board of directors between its regular meetings to take decisions on various matter of exigency and exercise delegated powers.
3. It may review and coordinate information from other committees.
4. It should meet at least eight times a year.

✿ **AUDIT COMMITTEE**

1. The Audit committee should comprise of at least four non-executive directors.
2. The Audit committee is established to give additional assurance regarding the quality and reliability of the financial information used by the board and financial information issued by the bank.
3. Its activities would normally include reviewing financial statement and inspections report, ensuring the sound functioning and the compliance with the various relevant statutes.
4. The Audit committee should ensure that adequate mechanism for prevention and detection of frauds is in place.
5. The Audit committee confirm to the board once a year that the internal controls of the bank are adequate.
6. The committee should meet at least six times a year.

✿ **NOMINATION COMMITTEE**

1. The Nomination Committee should comprise of the chairman, the executive director and at least two non-executive directors.
2. The Nomination committee should recommend the names of proposed directors to the board.
3. There should be a formal process for selection of non-executive directors based on performance.

4. It should meet at least once in a year.

✿ **COMPENSATION COMMITTEE**

1. The Compensation committee should comprise of the chairman, the executive director and at least two non-executive directors.

2. It should take decisions pertaining to annual adjustments in the emoluments given to the employees, performance pay etc.

3. It should establish personnel policies and review them periodically, making sure that employees are appropriately compensated and motivated to perform better.

4. It should meet at least once in a year.

✿ **RISK REVIEW COMMITTEE**

1. The Risk review committee should comprise of the chairman, the executive director and at least two non-executive directors.

2. It should oversee the bank's entire balance sheet, capital, funding and asset allocation.

3. The major concerns of this committee should include capital adequacy, interest rate sensitivity, quality of credit, and specific issues dealing with investment and lending.

4. It should review various risks of the banks i.e. currency risk, credit risk, investment risk etc.

5. It should meet at least four times in a year.

✿ **STAKEHOLDERS' RELATIONS COMMITTEE**

1. The Stakeholders' relation committee should comprise of the chairman, the executive director and at least two non-executive directors.

2. The Committee should be under the chairmanship of a non-executive director.

3. It should specifically look into the redressal of stakeholders complaints.

4. It should review relations with the regulatory bodies, investors, government etc., and the adequacy of communication with them.

5. It should meet at least twice in a year.

IMPORTANCE OF CORPORATE GOVERNANCE IN BANKS

Banks are social institutions acting as intermediary for financial transactions and derive their legitimacy from their ability and desire to fulfill a social need. As social institutions, they are ultimately answerable to the society. A number of high profile corporate failures in 2000-03 have brought a renewed focus on the importance of good corporate governance, bringing the topic to a broader audience.

CORPORATE GOVERNANCE IN BANKS

Banks occupy a central place in the payment and settlement system of a country and play a major role in the allocation of resources. As depository institutions, they are the custodians of public money. Due to linkage with real sectors, banking is considered as a barometer of economic health of a nation and statesmen take pride in projecting a banking system that symbolizes strength and stability. At the same time, the banking sector is characterized by inherent instability and a wide array of risks. Fragility of banks and interconnection between them through a complex chain of inert bank relationships, make the system vulnerable to failure which through contagion effect, erodes public confidence and prompts the specter of massive 'Runs'. High gearing ratio and asset liability mismatch act as catalysts to precipitate the crisis. The costs of such systemic shocks are manifold and the entire nation has to pay dearly for it. It is for their pivotal role in the society and the damage that can be caused by sudden and unexpected collapse of banks, that the subject attracts overwhelming public concern. Good governance is of interest not only to an individual's bank but also to the society in which it operates -the basic objectives being protection of depositors and safeguarding the integrity and soundness of the system. Corporate governance has been defined by the Cadbury Committee as the manner in which companies are directed and controlled. However, the term is a slippery one and eludes a simple definition. It has quickly come to mean many things to different people. The central role of risk management in good governance in banks has also been epitomized by Walter Wriston, ex-CEO of Citibank, who pronounced that "*the business of banking is the business of risk management, plain and simple, that is the business of banking*". The long

and painful experience that the root cause of banking crisis has been the breakdown in risk management system within the banks and poor risk management, ultimately, is the failure of the corporate governance. Effectiveness of banks' internal governance system has a very salubrious effect on its ability to identify, monitor and control risks. The regulation of banking institutions, therefore, has to be complemented by and reinforced with good corporate governance, especially in view of the proposed new Basel Capital Accord

THE NEW BASEL CAPITAL ACCORD

The new proposal is based on three mutually reinforcing pillars that allow banks and supervisors to evaluate properly, the various risks that banks face and realign regulatory capital more closely with underlying risks. Each of these three pillars has risk mitigation as its central plank. The new risk sensitive approach seeks to strengthen the safety and soundness of the industry by focusing on:

✿ **Risk Based Capital (Pillar I)**

✿ **Risk Based Supervision (Pillar II)**

✿ **Risk Disclosure To Enforce Market Discipline (Pillar III)**

PILLAR I: MINIMUM CAPITAL REQUIREMENT

The first pillar proposes to replace the existing 'one-size-fit-all' framework for assessment of capital with a variety of options. As William J Mc Donough, Chairman of Basel Committee observed, *"The framework will motivate banks to improve continuously their risk management capabilities so as to make use of more risk sensitive option and thus produce more accurate capital requirement."*

PILLAR II: SUPERVISORY REVIEW PROCESS

The second pillar contains evaluation procedures through which supervisors ensure that each bank has sound internal processes in place to assess the adequacy of its capital and set targets for capital that are commensurate with the bank's specific risk profile and control environment. The internal process would then be subject to supervisory review and intervention, where appropriate.

PILLAR III: MARKET DISCIPLINE

The third pillar aims to bolster market discipline through enhanced disclosure. It sets out disclosure requirement in several areas, including the way a bank calculates its capital adequacy and its risk assessment methods. Effective disclosure is essential to ensure that market participants can better understand bank risk profiles and the adequacy of their capital position. In short, the new accord proposes to offer commensurate rewards for banks to factor in sound risk management system in their structural reorientation strategy.

GOVERNANCE OF BANKS: SPECIAL FEATURES

As discussed, banks have two traits that motivate a separate analysis. Specifically, banks are generally more opaque than non-financial firms and governments heavily intervene in the banking industry more frequently. The authors now examine the implications of these traits for the governance of banks.

OPAQUENESS OF BANKS: IMPLICATIONS FOR CORPORATE GOVERNANCE

1. OPAQUENESS: IMPLICATIONS FOR GOVERNANCE BY EQUITY AND DEBT HOLDERS

The greater informational asymmetries between insiders and outsiders in banking make it very difficult for diffuse equity and debt holders to monitor bank managers. As noted, controlling owners have incentives to increase the bank's risk profile. Debt holders, however, do not enjoy any upside potential from risk taking but do on the downside if the bank cannot service its debts. The greater opacity of banks makes it harder for debt holders to control banks from this risk shifting. In terms of incentive contracts, greater informational asymmetries make it more difficult to design contracts that align managers' interests with bank equity holders. When outcomes are difficult to measure and easy to influence in the short-run, managers will find it easier to manipulate pay-offs from 'compensation' packages. Bankers who are interested in boosting their compensation in the short run can give a high interest loan to a borrower in trouble, thereby boosting interest income. And by controlling significant pools of resources, bankers can move asset prices that trigger payments to themselves under incentive contracts. Furthermore, since managers frequently control the

board of directors that write the incentive contracts, managers of opaque banks can often design compensation packages that allow managers to benefit at the expense of the long-run health of the bank. While many argue that large creditors e.g., holders of subordinated debt and debentures can ease informational asymmetries in banks and boost corporate governance, there are complicating factors. Large creditors rely on legal systems that are frequently unable to support their rights, with adverse implications for corporate governance. Also, large creditors may use their insider status to benefit themselves at the expense of the less-informed investors and efficient corporate governance as shown by Calomiris and Powell (2000). Beyond these complicating factors, there are other difficulties associated with relying on subordinated debt to improve governance as discussed below. Opaqueness also makes it easier for insiders to exploit outside investors and the government. In many countries, the domination of large sectors of the economy by relatively few families makes insider abuses more likely, most often at the expense of outside equity investors, depositors, and ultimately taxpayers. La Porta, Lopez-de-Silanes and Zamarripa (2003) find high rates of connected lending in Mexico. They find that 20% of total loans go to related parties. These loans benefited from interest rates that were about 415-420 basis points below those to unrelated parties. Related borrowers also benefited from longer maturities, were significantly less likely to have to post collateral, were 33% less likely to pay back, and the recovery rates on these loans were massively less (78 percent lower) than on loans to unrelated parties. Similarly, Laeven (2001) presents evidence that insiders in Russian banks diverted the flow of loans to themselves and then defaulted 71% of the time.

2. OPAQUENESS: IMPLICATIONS FOR GOVERNANCE BY COMPETITION

The opacity of banks can weaken competitive forces that, in other industries, help discipline managers through the threat of takeover as well as through competitive product markets. Product market competition is frequently less intense in banking. Bankers typically form long-run relationships with clients - to ameliorate the informational problems associated with making loans- and these relationships represent barriers to competition. Takeovers are likely to be less effective when insiders have much better information than potential purchasers. Even in industrialized countries, hostile takeovers tend to be rare in banking (Prowse, 1997). Indeed, long delays in the regulatory approval process associated with bank purchases makes hostile takeovers in banking extremely rare. Post-failure takeover, which is happening with greater frequency, almost by definition, does not affect managerial incentives. Furthermore, the absence of an efficient securities market hinders takeover and hence corporate governance. If potential corporate raiders cannot raise capital quickly, this will reduce the effectiveness of the takeover threat. Similarly, if bank shares do not trade actively in efficient equity markets, this will further hinder takeovers as an effective governance mechanism. Moreover, the absence of efficient securities markets means that many financial instruments such as subordinated debt and debentures -- that might be used to limit managerial discretion do not exist. There exist sound motivations for creating a group of large, sophisticated uninsured creditors with the incentives and ability to monitor banks as a plan for enhancing corporate governance. Nonetheless, this plan presupposes the existence of efficient securities markets, which do not exist in most countries.

BANK REGULATION: IMPLICATIONS FOR GOVERNANCE

1. Regulation: Implications For Governance By Shareholders And Competition : Although concentrated equity is a common corporate governance mechanism for dealing with the inability of diffuse equity holders to exert effective corporate control, most governments restrict the concentration of bank ownership and the ability of outsiders to purchase a substantial percentage of bank stock without regulatory approval. These restrictions may arise due to concerns about concentrations of power in the economy or about the type of people who control a bank. These restrictions are put into effect usually by requirements that purchasers of bank stock have to alert government officials as their holdings increase above a certain level, and may need regulatory approval above some proportion. Of the 107 countries in the Barth, Caprio, Levine (2003, henceforth BCL) database of bank regulation and supervision, 41 have a limit on the percentage of bank capital owned by a single entity that is less than 50% and 38 have limits less than 25%. Additionally, there may be constraints on who can own banks, such as the prohibition on ownership by nonbank firms, or by securities firms or insurance companies in some countries (such as the United States till recently). Nonetheless, a perverse paradox seems to operate: government regulatory restrictions are often ineffective at limiting family dominance of banks, but the regulatory restrictions on purchasing equity actually protect

these family-controlled banks from takeover and hinder corporate governance. There are a plethora of channels by which powerful families have built up control in banks and nonbank firms, as in the case of East Asia (Claessens, et al). More broadly, Caprio, Laeven, and Levine (2003, henceforth CLL) show that families frequently enjoy control rights over banks through pyramid and other schemes. Indeed, CLL show that around the world, banks are typically not widely-held; rather, 75 percent of banks have a single owner that holds more than 10 percent of the voting rights. Of these controlling owners, more than half are families. The regulatory restrictions on share purchases, therefore, do not prevent family ownership but rather defend the existing owners from competition for control.

2. Regulations: Implications For Governance By Depositors : Deposit insurance, implicit or explicit, substantively changes the equity and debt channels of corporate governance in a number of manners. First, deposit insurance reduces the incentives of depositors to monitor banks, which directly hinders corporate governance. Second, deposit insurance induces banks to rely less on uninsured creditors with incentives to monitor and more on insured depositors with no incentives to exert corporate governance. Third, deposit insurance - along with the rise of central banks as lenders of last resort- have helped produce banks with very low capital-asset ratios relative to other firms. As capital-asset ratios fall, this increases the incentives of controlling owners to increase the riskiness of the bank. Thus, deposit insurance both increases the ability of owners to increase risk because depositors no longer have incentives to monitor and deposit insurance increases the incentives for bank owners to increase risk because of lower capital-asset ratios. Not surprisingly, therefore, countries with more generous deposit insurance tend to have a higher likelihood of suffering banking crises (Demirguc-Kunt and Detragiache, 2003).

3. Regulation: Implications For Competition : Many government interventions limit competition in banking. Governments frequently restrict ownership concentration and regulate who can own banks. This impedes competition for corporate control. In terms of reducing competition in output markets, many countries impose regulatory restrictions on banks' ability to underwrite equity, conduct real estate or insurance business, or take ownership in nonbank firms (see BCL). Furthermore, many countries impose minimum branching requirements (often in rural areas), directed credit guidelines, portfolio restrictions (such as minimum percentages of assets invested in government securities), liquidity requirements, and limits on interest rates and fees. While there may exist sound motivations, the regulating-hand of the government frequently restricts competition and thereby hinders a key corporate governance mechanism.

EMERGING CHALLENGES

Having successfully sailed through the turbulence of financial sector reform, the banking industry may again run into rough weather due to the brewing challenges.

✿**Product Innovation:** Rapid changes in technology are leading to the introduction of hitherto unimaginable product and process innovations. Complex and versatile financial derivatives such as swaps, options, caps, collars etc. have thrown tough challenges to the bankers and supervisors. They often lack the technical expertise and sophistication to properly comprehend the typical character of the instrument, let alone assessing the underlying risks.

✿**Market Integration:** Liberalization has necessitated dismantling of barriers between money, capital and forex markets paving the way for closer market integration. Fusion of different market segment to the other-imposing additional strain on the regulators.

✿**Universal Banking:** Combination of multifarious activities (banking, insurance, securities, portfolio management etc.) under the universal banking umbrella resulted in the creation of financial conglomerates. In India, with opening up of the insurance sector, many of the institutions are offering both banking and insurance products. Since banking and insurance come under different regulatory jurisdictions, the authority to be ultimately responsible for ensuring stability and solvency of the institutions is a question yet to be satisfactorily resolved.

✿**Globalization:** With globalization, no country can claim to be immune from cross-boarder developments. For example, the South East Asian currency crisis had its repercussion in the Indian forex market too. The aftermath of September 11, 2001 events in the US continues to haunt the global economic outlook including India. Another aspect of globalization is that a significant proportion of a global bank's business is carried on outside the borders of the home country. This makes them vulnerable to contagious effects of cross border disturbance. Moreover, in spite of the pioneering efforts of the Basel Committee in that direction, problems of standardization of the supervisory responsibilities and harmonization of national accounting standards still persist.

✿**Technology:** Of all the issues the industry faces in the years ahead, one stands far from the rest, how to deal with technology? Technology has become the key driver of banking business and is redefined its boundaries. At the same time, widespread use of computer and internet technology has increased the risk of technology related frauds and malpractice. Current trend of transition from distributed banking to core banking will pose additional challenges.

EMERGING ISSUES

Apart from the emerging challenges, a few issues having policy implications that continue to remain shrouded in controversy. Primarily, they relate to the following areas:

✿**Government Ownership:** Government ownership of the banking sector creates a number of problems for RBI as the regulator. The problem is particularly complex because the government often acts as a quasi-regulator. Therefore, it is to be decided whether good governance is compatible with government ownership.

✿**Checks and Balances:** In India, in most banks, the chairman and CEO positions are combined. This may create concentration of power in a single individual. It has been suggested that the roles of the Chairman and the CEO should be separated.

✿**RBI And Government Nominee Directors:** Whether RBI can effectively perform its role as a supervisor, when it is also represented on the Board through its nominee director, which may lead to conflict of interest with its regulatory function. More so, since the nominees of RBI and Government are treated as superior to other directors.

✿**Sectoral Representation:** Considering the current trend of liberalization, the representation given to various interest groups in the board for protection of their sectional economic interests, may have to be reviewed.

✿**Quality And Proportion Of Non-executive Director:** Only individuals of proven professional competence and experience and with special insight into specific economic activities may be appointed as non-executive directors. The optimum proportion of executive and non-executive directors continues to be a matter of debate.

✿**Delay In Filling Up Vacancies In The Board:** In many cases, there is long delay in filling up the vacancies in the board, which cripples its efficient functioning.

✿**Ceiling On Number Of Members In The Board:** The size of the board should not be too unwieldy so as to hamper its cohesiveness.

✿**Disparities In Remuneration Of Whole Time Directors:** Normally, the whole time directors of PSU banks are remunerated very poorly compared to their private sector counterparts. This anomaly is required to be addressed. Proper framework should also be developed for remuneration of non-executive directors.

STRATEGIES TO IMPROVE CORPORATE GOVERNANCE

1. Schedule Regular Meetings Of The Non-executive Board Members From Which You And The Other Executives Are Excluded : Non-executives are there to exercise “constructive dissatisfaction” with the management team. They need to discuss collectively and frankly their views about the performance of the executives, the strategic direction of the company and worries about areas where they feel inadequately briefed.

2. Explain Fully How Discretion Has Been Exercised In Compiling The Earnings And Profit Figures : These are not as cut and dried as many would imagine. Assets such as brands are intangible and with financial practices such as leasing common, a lot of subtle judgments must be made about what goes on or off the balance sheet. Don't hide these, but use disclosure to win trust.

3. Initiate A Risk-Appetite Review Among Non-Executives : At the root of most company failures are ill-judged management decisions on risk. Non-executives need not be risk experts. But it is paramount that they understand what the company's appetite for risk and accept, or reject, any radical shifts.

4. Check That Non-executive Directors Are Independent : Weed out members of the controlling family or former employees who still have links to people in the company. Also raise awareness of “soft” conflicts. Are there payments or privileges such as consultancy contracts, payments to favourite charities or sponsorship of arts events that impair non-executives' ability to rock the boat?

5. Audit Non-executives' Performance And That Of The Board : The attendance record of non-

executives needs to be discussed and an appraisal made of the range of specialist skills. The board should discuss annually how well it has performed.

6. Broaden And Deepen Disclosure On Corporate Websites And In Annual Reports: Websites should have a corporate governance section containing information such as procedures for getting a motion into a proxy ballot. The level of detail should ideally include the attendance record of non-executives at board meetings. If you have global aspirations, an English-language version must be available.

7. Lead By Example, Reining In A Company Culture That Excuses Cheating: Don't indulge in sharp practice yourself-others will take this as a green light for them to follow suit. If the company culture has been compromised, or if you are in an industry where loose practices on booking revenues and expenditure are sometimes tolerated, take a few high-profile decisions that signal change.

8. Find A Place For The Grey And Cautious Employee Alongside The Youthful And Visionary One: Hiring thrusting MBAs will skew the culture towards an aggressive, individualist outlook. Balance this with some wiser, if duller heads-people who have seen booms and busts before, value probity and are not in so much of a hurry.

9. Make Compensation Committees Independent: Corporate bosses should be prevented from selling shares in their firms while they head them. Share options should be expensed in established companies-cash-starved start-ups may need to be more flexible.

10. Don't Avoid Risk. No doubt corporate governance would be a lot simpler if companies were totally risk averse. But in the words of Helmut Maucher, honorary chairman of Nestlé, *"You have to accept risks. Those who avoid them are taking the biggest risk of all."*

CONCLUSION

Corporate governance in the case of the banking industry reveals that laws, shareholder interests, bank interests and sound economics are factors to take into account. Banks are to balance profits with regulatory requirements and sound economics so as to be successful and management practices to be considered include adequate representation of shareholders, allowing for monitoring, allowing for minority control and compliance with legal procedures. When banks efficiently mobilize and allocate funds, this lowers the cost of capital to firms, boosts capital formation, and stimulates productivity growth. Thus, weak governance of banks reverberates throughout the economy with negative ramifications for economic development. Regulators have the most crucial role in improving corporate governance. They are in fact external pressure points. Although compliance with regulatory requirements is an ideal situation, it is not enough for ensuring good corporate governance. The road to efficiency lies in minimizing regulatory prescriptions and maximizing voluntary codes to ensure excellence in corporate governance. Their orderly conduct is an essential prerequisite for a healthy economy. Moreover, efficient corporate governance will contribute to increased flow of capital from abroad.

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