



## CORPORATE GOVERNANCE: IMPACT ON THE PERFORMANCE OF BANKING AND INSURANCE SECTOR IN INDIA: AN EMPIRICAL STUDY

**Imrankhan, I. Pathan**

*Asst. Professor, C P Patel Commerce College, Anand, Gujarat, India.*

### Abstract

*Corporate Governance has gained a lot of importance and momentum the world over. The objective of any corporate governance system is to simultaneously improve corporate performance and accountability as a means of attracting financial and human resources on the best possible terms and of preventing corporate failure. Over the past decade, India has made significant strides in the areas of corporate governance reforms, which have improved public trust in the market. These reforms have been well received by the investors, including the foreign institutional investors (FIIs) and foreign direct investments (FDIs).*

**Keywords:** Corporate governance, financial performance, banking and insurance sector.

### INTRODUCTION

Corporate Governance is essentially all about how corporations are directed, managed, controlled and held accountable to their shareholders. In India, the question of Corporate Governance has come up mainly in the wake of economic liberalization and de-regularization of industry and business. Corporate governance is the set of processes, policies, to ensure proper management of companies for effective accountability to all stakeholders, aim to optimize economic output and protect the interest of shareholders. It includes in its orbit all implicit and explicit relationships between the corporation and its employees, customers, creditors, suppliers and all other stakeholders. The issue of corporate governance has come up mainly in the wake up of economic reforms characterized by liberalization and deregulation. Corporate governance has at its backbone a set of transparent relationships between an institution's management its board, shareholders and other stakeholders. With the rapid pace of globalization many companies have been forced to tap international financial markets and consequently to face greater competition than before. Both policymakers and business managers have become increasingly aware of the importance of improved standards of Corporate Governance.

Corporate governance has, of course, been an important field of query within the finance discipline for decades. The initiative in India was driven by 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 released in 1998 and was called Desirable Corporate Governance: A Code". According to Mayer (1997), Corporate Governance could be defined as ways of

bringing the interests of investors and managers into line and ensuring that firms are run for the benefit of investors. It is concerned with the relationship between the internal governance mechanisms of corporations and society's conception of the scope of corporate accountability (Deakin and Hughes, 1997). In their model, Bolton, Mehran, and Shapiro (2011) demonstrate that shareholders may not have the incentive to reduce risk taking at a firm, even if it is in their own interest due to commitment problems.

Panchali (2002) examines the rationale for institutional investor activism in the capital market while Sarkar (2009) examined the function of corporate boards and the rights and responsibilities of board members. Effective corporate governance systems promote the development of strong financial systems – irrespective of whether they are largely bank-based or market-based – which, in turn, have an unmistakably positive effect on economic growth and poverty reduction. The return on assets (ROA) is about twice as high in the countries with the highest level of equity rights protection as in countries with the lowest protection (Claessens, 2003). A McKinsey survey conducted in 2002, found that investors were willing to pay a premium of up to 25% for a well governed company (Barton, Coombes, & Wong, 2004). The scandals related to the Indian markets (Goswami, 2002), the global financial crisis of 2008 and the more recent corporate fraud at Satyam has raised a lot of concerns about governance practices in India. Good corporate governance also lowers the cost of capital by reducing risk and creates higher firm valuation once again boosting real investments (La Porta et al, 2000). Studies have also built governance indices and have tested its association with performance. The results indicate that governance has a positive impact on

performance (Patibandla 2006; Samontary, 2010).

### OBJECTIVES OF THE STUDY

Corporate governance is about ensuring that a business performs well through the adoption of fair and ethical principles and those investors receive a reasonable return. The governance framework provides the overall direction to management and ensures accountability to shareholders and other stakeholders. Given the pivotal role that banks play in the financial and economic system of a developing country, bank failure owing to unethical or incompetent management action poses a threat not just to the shareholders but to the depositing public and the economy at large. It is partly for these reasons that prudential norms of banking and its close monitoring is essential for smooth functioning of the banking sector. The objective of present study is to evaluate the corporate governance practice in banking and insurance sector. For evaluation purpose, this research paper divided into two parts. Based on different elements of and with the help of secondary data, the present study has analyzed and evaluated the practice of corporate governance and the performance of banking and insurance sector in India during the post-liberalization period i.e. from 2000-01 to 2012-13.

### RESEARCH METHODOLOGY

The present study is exclusively based on secondary data. The relevant data has been collected from the economic surveys, RBI monthly bulletins, handbook of statistics on Indian economy, etc. The period of study is confined to 13 years time period i.e. from 2000-01 to 2012-13. The study is further divided into two periods, namely period-I i.e. from 2000-01 to 2005-06, called as early-phase of the post-liberalization and period-II i.e. from 2006-07 to 2012-13, called as lateral-phase of post-liberalization period. Moreover, the performance of banking and insurance industry in terms of critical economic parameters such as GDP contribution, organised employment and FDI inflows has also been analyzed. The secondary data has been analyzed with the help of various statistical techniques such as mean, standard deviation, exponential growth, range, coefficient of variation and student 't' test.

### CORPORATE GOVERNANCE IN INDIAN BANKING AND INSURANCE SECTOR

The corporate governance practice is important for banks in India because majority of the banks are in public sector, where they are not only competing with one another but with other players in the banking system. Further, with restrictive support available from the government for further capitalization of banks, many banks may have to go for public issues, leading to transformation of ownership. The banking system in India is significantly different from that of other nations because of the country's unique geographic, social and economic characteristics. Globalisation of the Indian economy and the interest of foreign banks to expand in India through the inorganic route have fuelled growth of the banking industry. The Reserve Bank of India (RBI) has well-formulated regulations. A good mix of public and private sector banks provides stability and growth to the economy. In addition, non-banking financial institutions, cooperative banks, primary agricultural societies etc., are spread across the country to meet local needs. The Indian financial sector underwent significant changes over the past 15 years due to a large set of reforms that were undertaken during this period. There has been a major change in the products offered by banks, from a few standard credit and deposit products to a number of customised offerings to suit the requirements of various categories of customers. India has now entered the era of online banking, e-commerce and m-commerce, which makes banking simple. Also, the use of ATMs and credit cards has increased significantly in the last few years.

According to Eleventh Five Year Plan (2007–2012), the infrastructure sector requires an investment of US\$ 428.4 billion. In 2009–10, the insurance industry contributed US\$ 16.1 billion to infrastructure funding. The life insurance sector employed 0.3 million people directly and 2.9 million people as individual agents in 2009-10. Government's proposed increase of Foreign Direct Investment (FDI) limit in insurance sector to 49 per cent from 26 per cent will further fuel investments. India is among the world's youngest nations, with a median age of 25 years as compared to 43 in Japan and 36 in the US. This coupled with the increasing disposable income and growing demand for personal financial security indicates a promising future for the insurance industry (Gupta, 2009).

**Table 1:** FDI INFLOWS IN MAJOR SERVICE SECTORS (from 2000-2013) (Rs. Crores)

Sector	FDI Inflows				FDI Inflows			
	[2000-01 to 2005-06]				[2006-07 to 2012-13]			
	Sum	Max.	Min.	Range	Sum	Max.	Min.	Range
<b>Banking and Insurance</b>	2,512	687	83	604	31,036	5,968	928	5,040
	(2.57)				(3.92)			
<b>Housing and Real Estate</b>	438	178	121	57	51,236	14,027	2,121	11,906
	(0.45)				(6.47)			
<b>Hotel and Tourism</b>	961	287	47	240	30,906	17,777	610	17,167
	(0.98)				(3.90)			
<b>Computer Software</b>	14,600	6,172	604	5,568	39,119	11,786	2,656	9,130
	(14.93)				(4.94)			
<b>Others</b>	79295	n.a.	n.a.	n.a.	6,38,973	n.a.	n.a.	n.a.
	(81.07)				(80.75)			
<b>Total FDI inflows</b>	97,806	24,613	12,117	12,496	7,91,270	1,65,146	70,630	94,516
	(100)				(100)			

Source: DIPP, Federal Ministry of Commerce and Industry, Govt. of India.

According to National Accounts estimates, the share of services sector in India's GDP at factor cost (at current prices) has increased from 33.5 percent in 1950-51 to 55.1 percent in 2010-11 and to 56.3 percent in 2011-12 as per Advance Estimates (AE). The growth rate of services sector has been higher than that of agriculture and manufacturing sector. Though all three sectors of the economy have seen tremendous growth during the last sixty-two years and have contributed to the GDP growth rate, the growing importance of service sector particularly in the aftermath of reforms is a sign of India's being projected as superpower of future. It can be observed from the table that among major service sectors, the highest FDI equity inflows during the period 2006-12 has been in housing and real estate, which accounts for nearly 6.47% (Rs. 51,236 crores) of the total FDI inflows followed by computer software with 4.94% (Rs. 39,119 crores) and banking & insurance sector with 3.92% (Rs. 31,036 crores) of the total FDI inflows. The table also depicts that overall these major service sectors accounts for 18.25% (Rs. 1,52,297 crores) of total FDI inflows in India during 2006-12 in comparison to 18.93% (Rs. 18,511 crores) of the total FDI inflows during 2000-05 respectively. This shows the role of services sector in attracting major foreign investment inflows and thereby contributing towards the development of an economy since liberalisation. As a result, over the years, India has been witnessing a transition from agriculture-based economy to a knowledge based economy. All this shows that services hold immense potential to accelerate the growth of an economy and promote the general well-being of people.

Thus, while evaluating the performance & contribution of services sector in Indian economy, various economic indicators like share in national and states' GDP, FDI, employment, imports and exports, etc. indicates the effectiveness of the services sector for Indian economy. However, addressing the data problems in the services sector is another area where there is need for early consolidation of isolated efforts. By addressing these challenges of various sub-sectors of the services industry through better and coordinated strategies can lead to exponential gains for the economy.

#### PERFORMANCE OF BANKING AND INSURANCE SECTOR

The banking system in India is significantly different from that of other nations because of the country's unique geographic, social and economic characteristics. Globalisation of the Indian economy and the interest of foreign banks to expand in India through the inorganic route have fuelled growth of the banking industry. The Reserve Bank of India (RBI) has well-formulated regulations. A good mix of public and private sector banks provides stability and growth to the economy. In addition, non-banking financial institutions, cooperative banks, primary agricultural societies etc., are spread across the country to meet local needs. The Indian financial sector underwent significant changes over the past 15 years due to a large set of reforms that were undertaken during this period. There has been a major change in the products offered by banks, from a few standard credit and deposit products to a number of customised offerings to suit the requirements of various

categories of customers. India has now entered the era of online banking, e-commerce and m-commerce, which

makes banking simple. Also, the use of ATMs and credit cards has increased significantly in the last few years.

**Table 2: PERFORMANCE OF BANKING & INSURANCE SINCE POST-LIBERALISATION**

Macro-Economic Aggregates	Early Phase of Post-Liberalisation [2000-01 to 2005-06]				Lateral Phase of Post-Liberalisation [2006-07 to 2012-13]				't' value
	Mean	Stand. Deviat.	Expon Growth	COV %	Mean	Stand. Deviat.	Expon Growth	COV %	
FDI (Rs. Crore)	418.67	231.69	29.73	55.34	4433.71	1794.56	17.27	40.47	5.41*
Employment (Lakh person)	10.31	0.203	- 0.81	1.97	10.61	0.294	1.22	2.77	2.14
GDP Factor Cost (Rs. Crore)	150520	18784.72	5.54	12.48	228838	28986.62	5.89	12.67	5.66*

**Note:** \* Denotes significant at 1% level

**Source:** Economic Surveys of India & RBI's monthly Bulletins on FDI (various issues).

The table portrays the performance of India's Banking and Insurance sector since post-liberalisation. One of the key trends in banking sector over the recent years has been a large spate of consolidations through mergers and acquisitions (M&A's). The FDI inflows have a mean value of Rs. 4,433.7 crores and registered a growth of 17.3% during 2006-2012. Similarly, the employment growth during early-phase of liberalisation registered a negative growth of (-) 0.81% with mean value 10.31 lakh employees, which increased to 1.22% along with a mean value 10.61 lakh employees respectively during 2006-12. This shows a considerable improvement in the performance indicators of this sector as a result of various reform measures. The table also depicts computed 't' values of various macro-economic parameters i.e., GDP, FDI and employment at 1% level of significance i.e. 2.898 and it was found that computed 't' value of GDP and FDI was much higher, which thereby indicates a statistically significant difference in GDP contribution and FDI inflows during the early-phase and lateral-phase of the liberalisation period.

## CONCLUSION

The Indian banking system is among the healthier performers in the world. In the liberalized economic environment and integration of the country at present the banking sector in India cannot ignore the importance of corporate governance. Thus, the success of Indian financial sector can be judged from the fact that despite being characterized by low per capita GDP, India has achieved an impressive savings rate as well as financial depth. The Indian financial sector has proved to be an integral sector of the economy. Given that services sector will become the largest in India, both insurance

and banking sector will have to play a critical role.

## REFERENCES

1. Barton, D., Coombes, P. & S. C Y Wong (2004), "Asia's governance challenge", McKinsey Quarterly 2: pp.54-61.
2. Bolton, P., Mehran H. and Shapiro, J. (2011), "Executive Compensation and Risk Taking", Mimeo, Federal Reserve Bank of New York.
3. Claessens, S. (2003), "Corporate Governance and Development", Global Corporate Governance Forum, World Bank, Washington D.C.
4. Deakin, Simon and Hughes, Alan (1997), "Comparative Corporate Governance: An Interdisciplinary Agenda, Journal of Law and Society", Volume 24, Issue 1, pp.1-9.
5. Goswami, O (2002). "Corporate governance in India: taking action against corruption in Asia and the Pacific". Asian Development Bank. Manila, Philippines, pp.85-106.
6. Gupta, Abhijit (2009), "Banking and Insurance Services Liberalization in the context of an Indo-EU Trade and Investment Agreement", ICRIER.
7. La Porta, R., F. Lopez-de-Silanes, A. Shleifer, R. Vishny (2000), "Investor Protection and Corporate Governance", Journal of Financial Economics, 58, pp.3-27.
8. Mayer, Collin (1997), "Governance, Competition, and Performance, Journal of Law and Society", Volume 24, Issue 1, pp.152-176.
9. Panchali, J. (2002). "Institutional investors & corporate governance" IIMB Management Review 14 (1): pp.23-45.

10. Patibandla, M. (2006). Equity pattern, corporate governance and performance: A study of India's corporate sector, *Journal of Economic Behaviour & Organization* 59(1): 29-44.
11. Samontary, D. P. (2010): "Impact of Corporate Governance on the Stock Prices of the Nifty 50 Broad Index Listed Companies", *International Research Journal of Finance and Economics* 41, pp.1-8.
12. Sarkar, J. (2009). "Board Independence and Corporate Governance in India: Recent Trends and Challenges Ahead" *Indian Journal of Industrial Relation* 44 (4): pp.554 -575.