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Impact of Corporate Governance on the Performance of Indian banks

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ABSTRACT

With the help of the panel data method, this study looks at how corporate governance affects the performance of India's banking sector from 2014–15 to 2021–22. The study incorporates corporate governance elements like the number board of directors, board composition and CEO duality. Two financial matrics has been used i.e. ROA and ROE. Results depict that when the performance is measured by return on assets, corporate governance variables board size and CEO duality have significant impact whereas, only CEO duality has substantial influence on performance when measured by return on equity. Moreover, among macro variables, capital adequacy ratio and leverage are significantly affecting the performance (ROA and ROE).

Keywords: *Corporate governance, Indian banks, Performance, capital adequacy ratio, board size.*

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INTRODUCTION

Corporate control, or governance depending on context, is the formal framework of rules, norms, and procedures by which a sustainable business operates. So, it's a system whereby the board of directors maintains accountability, guaranteeing the continued prosperity of the business (Eriki & Eburajolo 2021). While numerous studies have focused on the topic of corporate governance, the importance of good governance for the sound banking system, which is crucial not only to the national but also to the global financial system, was not a subject of empirical studies until recently, especially after the occurrence of the 2008 financial crisis (Abobakr 2017). For the Indian economy to function, banks are crucial. Banking institutions have a broader impact on the economy and its subsectors because of their role as money lenders (Shukla 2020).

Every financial institution needs to have a robust bank governance framework in place to instil trust, security, and openness among its customers. The battle against corruption is directly tied to more efficient and successful banking operations, which is why it is important to have safe and secure banking procedures in place (Muhaissen and Alobidyeen 2021). The corporate board plays a critical role in a well-run business, as it is responsible for overseeing key management decisions and putting into action the bank's overall strategy. The bank's board acts as an intermediary between the institution and its external stakeholders. Also, it plays a governance function by keeping an eye on the decisions made by upper-level management. The bank's future growth and development are primarily the responsibility of the corporate board, which also provides strategic direction (Nyuur *et al.* 2020).

The goal of this paper is to look into the link between corporate governance and the performance of Indian public and private banks. In this paper, traditional methods of performance measurement i.e. ROA and ROE have been used. Out of corporate governance, size of board, board composition and CEO duality have been utilized to find out that how much they effects the performance of Indian banks. Remainder of the paper is structured as follows: section 2 represents the empirical literature related to effect of corporate governance on bank performance. Next section exposes the research methodology which includes data sample, variables measurements and methodology. Section 4 presents the results and discussions. The conclusion and future recommendations will be presented in Section 5 and 6 respectively.

LITERATURE REVIEW

BDSIZE

Size of the board, as represented by the number of directors, is a key indicator of sound corporate management practises. As a result of earlier literature, it can be concluded that the number of BODs have mixed results on the bank performance. Muhaissen and Alobidyeen (2021), Goet 2022, Bhatt& Bhattacharya2015, Aslam & Haron 2020, Okoyeuzu et al. 2021, Daadaa2020, Nyuur *et al.* 2020, Abobakr 2017, Saidi and Shammari (2013) explored significant association of board size with the bank performance. While Musah and Adutwumwaa (2021) and Handa 2020 found board size to be an insignificant factor in measuring the performance of banks. Molla *et al.* 2021 examined that number of BODs is significantly related to performance when measured by ROA and ROE whereas it is insignificantly related to performance when measured by Tobin's q. On the basis of above arguments, the following hypothesis has been developed:

H1: BDSIZE is not significantly related to bank performance.

BDCOM

Board composition means how many executive directors and how many non-executive directors are on the board. As per the empirical study of Musah and Adutwumwaa (2021), Okoyeuzu *et al.* 2021 and Handa 2020, it is concluded that presence of non-executive directors on the board is an important factor for improving the performance of banks. On the other side, studies of Bhatt & Bhattacharya 2015, Molla *et al.* 2021, Daadaa2020, Abobakr 2017 and Saidi and Shammari (2013), board composition is treated as insignificant variables while measuring bank performance. Aslam & Haron 2020 and Nyuur et al. 2020 found the mix results related to board composition. Based on the above arguments, the following hypothesis has been developed:

H2: BDCOM is insignificantly associated to bank performance.

CEODUA

The term "CEO duality" refers to when the same person is both the chair of the board and the CEO, or an equivalent role in the banking industry. Musah and Adutwumwaa (2021) and Daadaa2020 explored that having same person as CEO and Chairman is not important for the performance of banks. While, Handa 2020, Abobakr 2017 and Saidi and Shammari (2013) found it as an important factor in improving the performance of banks. Bhatt & Bhattacharya 2015 and Aslam & Haron 2020 investigated that the importance of CEO duality is different for different measurements of bank performance. Based on the above arguments, the following hypothesis has been developed:

H3: CEODUA is related to bank performance insignificantly.

RESEARCH METHODOLOGY

SAMPLE AND COLLECTION OF DATA

The study used the sample of Indian public and private banks. Only 25 public and private banks were selected for the period of 2014-15 to 2021-22. Rest of the banks were excluded because of data unavailability. All authentic sources have been used to extract the data. Data related to corporate governance has been collected from the annual report of concerned bank. Prowess IQ has been used to collect the data pertaining to ROA, ROE, bank size, leverage and CRAR.

VARIABLES

Dependent variables

Return on Assets (ROA) and Return on Equity (ROE) are utilised as two accounting-based measurements of the financial performance of the banks.

Independent variables

There are many corporate governance factors which affect the performance of banks. The study used size of board (BDSIZE), board composition (BDCOM) and CEO duality as independent variables.

Control variables

The study incorporates other factors that may have a major bearing on the banking firms' results. The bank-specific factors that may have impact on their performance includes leverage (LEV), capital adequacy ratio (CRAR) and total assets of banks (BKSIZE).

METHODOLOGY

The impact of banks' corporate governance on their performance is examined through two models presented below:

ROA= $\alpha 0 + \beta 1 BDSIZE + \beta 2 BDCOM + \beta 3 CEODUA + \beta 4 LEV + \beta 5 BKSIZE + \beta 6 CRAR$+ E

ROE= $\alpha 0 + \beta 1 BDSIZE + \beta 2 BDCOM + \beta 3 CEODUA + \beta 4 LEV + \beta 5 BKSIZE + \beta 6 CRAR$+ E

Where,

ROA= Return on assets

ROE= Return on equity

BDSIZE= Board size

BDCOM = Board composition

CEODUA= CEO duality

LEV= Leverage

BKSIZE= Bank size

CRAR= Capital adequacy ratio

RESULTS

CORRELATION MATRIX

Using a variables correlation matrix, the researcher checks for the presence of multicollinearity. Coefficient values below 0.70, indicative of the absence of multicollinearity among the variables, are reported in the correlation analysis. The Hausman test is then used to select between the random effect and fixed effect models. As the probability value is less than the 0.05 significance level, the findings are consistent with the fixed effect hypothesis.

Table 1. Correlation Matrix

	BDSIZE	BDCOM	CEODUA	CRAR	LEV	BKSIZE
BDSIZE	1					
BDCOM	0.705955	1				
CEODUA	-0.38212	-0.44111	1			
CRAR	0.148725	0.179281	-0.3635	1		
LEV	0.190486	0.071285	-0.1785	-0.12296	1	
BKSIZE	0.150489	-0.31088	0.066877	0.04628	0.324039	1

Source: Author Calculation

SUMMARY OF DESCRIPTIVE STATISTICS

Table 2 presents the results of descriptive statistics. Average return on assets is 0.39. Negative ROE speaks about the weak financial health of banks during the sample period. Banks are having large board with the mean 10.13. Average size of board composition is 7.48 which implies that 74% members are non-executive in Indian banks. Average number of CEO duality is 0.31. Leverage having mean of 1.0446 indicates that only a small portion of finance is arranged through debt. Average of 14.18 of capital adequacy ratio implies good risk absorption capacity of Indian public and private banks. On an average, total assets of banks is 14.68.

Table 2. Descriptive statistics results

	Mean	Median	Maximum	Minimum	Std. Dev.
ROA	0.39645	0.49	2.13	-5.39	1.080999
ROE	-0.01105	6.22	21.33	-76.14	18.09652
BDSIZE	10.13	10	15	6	1.873674
BDCOM	7.48	8	14	2	2.20543
CEODUA	0.31	0	1	0	0.463654
LEV	1.0446	0.855	5.24	0.06	0.757488
CRAR	14.1825	13.75	24.14	8.5	2.804041
BKSIZE	14.68578	14.76	17.72715	11.69	1.107773

To estimate the relation of corporate governance and bank performance of Indian public and private banks, the study used panel data regression model. The results are discussed in Table 3. When the performance is measured by return on assets (ROE), the results depicts that board size is positively significantly affecting bank performance. One possible explanation for this is that boards with more members have access to more specialised knowledge, leading to better decisions (Bhatt *et al.* 2015). Above results are consistent with the findigns of Goet 2022 Bhatt & Bhattacharya 2015, Molla et al. 2021, Nyuur et al. 2020 and Abobakr 2017. Consistent with the assertions of Handa 2020, Abobakr 2017 and Saidi and Shammari (2013), the study looks at the significant and positive link between CEO duality and the performance of Indian banks (ROA and ROE).The stewardship theory, according to which the CEO's position as chairwoman improves the bank's profitability through more efficient management, is supported by the positive relationship of CEO duality. Concerning with the capital adequacy ratio, significant relation with performance (measured by ROA and ROE) is in contrast with the results of Handa 2020, Irawati et al. 2019, Abobakr 2017, Saidi and Shammari (2013). This scenario implies that a bank with higher capital equity is more likely to be successful in the face of financial danger. Consistent with the results of Handa 2020, Irawati et al. 2019, Abobakr 2017, Saidi and Shammari (2013), Goet 2022, Musah & Adutwumwaa (2021) and Okoyeuzu et al. 2021, the study finds the significant results of bank size with the Indian bank performance. Despite small banks' superior performance, large banks may have access to key resources and more political power. Therefore, larger banks perform better than their smaller counterparts (Saidi and Shammari (2013)). Another control variable, leverage affects Indian banks performance (ROA and ROE) significantly (Nyuur et al. 2020 and Saidi & Shammari (2013)). Negative impact of leverage on performance supports the findings of traditional theory of capital structure.

Table 3. Regression Results

VARIABLES	ROA	ROE
C	(0.2375)	(0.8044)
BDSIZE	(0.138389) 0.0485**	(1.834298) 0.1493
BDCOM	(0.009839) 0.8681	(0.242802) 0.8217
CEODUA	(0.546402) 0.0025*	(15.62978) 0*
LEV	(-0.49432) 0.0004*	(-6.5887) 0.0088*
CRAR	(0.094304) 0.0059*	(1.915914) 0.0022*
BKSIZE	(-0.29101) 0.0248**	(-3.67249) 0.1179
Observations	200	200
Adjusted R^2	0.569376	0.491825
F-Statistics (P-value)	0	0
Estimates	FE	FE

Notes: *p<0.01, **p<0.05

Source: Author compilation

CONCLUSIONS

The present research attempts to scrutinize the impact of corporate governance on the performance of Indian banks for the period of 2014-15 to 2021-22. For this purpose, bank performance is measured by return on assets, return on equity and corporate governance include board size, board composition and CEO duality. The study control for variables bank size, leverage, and capital adequacy ratio.

When performance is measured by return on assets then, except board composition, all variables have significant impact. Whereas, when return on equity is used as a proxy for performance, only CEO duality, CRAR and leverage have significant impact.

POLICY IMPLICATION AND FUTURE RESEARCH

The study has some practical implications. Academicians, managers, shareholders, and politicians can all benefit from the information provided by this study as they endeavor to strengthen Indian banking framework through better corporate governance. Regardless of the above, the study's findings offer scholars, policymakers, and practitioners valuable insights into the ways in which corporate governance affect various indicators of business success.

This study has some limitations also. Firstly, it focus on only Indian public and private banks. Thus, future research can be carried out by including the sample of other Indian banks. Secondly, only two measures of performance i.e. ROA and ROE have been used. So, other measures of performance can be used as a proxy to find the impact of corporate governance.

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