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An Overview On Corporate Governance In Indian Financial Institutions

Sasmita Sahoo

Research Scholar in Management, School of Commerce & Management Studies,
Ravenshaw University, Cuttack

Abstract: ***Corporate Governance involves a set of relationships between a company's management and its different stakeholders. Corporate governance provides a principled process and structure through which the objectives of the company, the means of attaining the objectives and systems of monitoring performance are also set.. It is about commitment to values, ethical business conduct and transparency. It makes a distinction between personal and corporate funds in the management of a company. Effective corporate governance practices are essential in achieving and maintaining public trust and confidence on the financial institutions, which are critical to the proper functioning of the institutions and economy as a whole. Poor corporate governance result into failure in financial institutions, which can pose significant public costs and consequences due to their potential impact on any applicable deposit protection systems and the possibility of broader macroeconomic implications, such as contagion risk and impact on payment systems. In addition, poor corporate governance can lead markets to lose confidence on the ability of financial institutions to properly manage its assets and liabilities, including deposits, which could in turn trigger a financial institutions run or liquidity crisis. Indeed, in addition to their responsibilities to shareholders, financial institutions also have a responsibility to their stakeholders. The issue of corporate governance in financial institutions, like any organization, needs to be addressed. Best corporate governance practices in financial institutions can lead to increased efficiency with reduced risks, easier access to capital markets with decreased cost of capital, increased growth rate, attractive strategic investment, improved standard of lending, safeguard minority shareholder and other counterparts, stronger reputation and clients' trust along with transparency in the affairs of the organization.***

Keywords: Corporate Governance, stakeholder, cost of capital, capital market

I. INTRODUCTION

With the increase use of information technology and office automation, the information requirement of the financial institution, management and investors has enhanced into many fold. It is a known fact that vital needs of success of any organization depends on its ability to mobilize and utilise all kinds of resources to meet the objectives clearly set as part of the planning process. Both internal and external factors are necessary for well management of financial institution, the latter include availability, cost effectiveness; technological advancement. Increasingly, revelations of deterioration in quality and transparency, have called for adoption of internationally accepted 'Best Practices'. Corporate governance is about ethical conduct in business. Ethics is concerned with the code of values and principles that enables a person to choose between right and wrong, and therefore, select from alternative courses of action. Further, ethical dilemmas arise from conflicting interests of the parties involved. In this regard, managers make decisions based on a set of principles influenced by the values, context and culture of the organization. A company in a global economy where access to capital markets is in the interest of economy assumes greater significance. Strong corporate governance is indispensable for growth of capital market and is an important instrument of investor protection. Good corporate governance makes to the efficiency of a business enterprise, to the creation of wealth and to the country's economy. The need is for the entire corporate word to follow the principles of corporate governance.

Corporate governance is a system of making Management accountable towards the stakeholders for effective running of the companies. Corporate governance is also concerned with the morals, ethics, values, parameters, conduct and behaviour of the company and its management. The underlying principles of corporate governance revolve around three basic interrelated segments. These are:

- ✓ Integrity and Fairness
- ✓ Transparency and Disclosures
- ✓ Accountability and Responsibility

It is essential to monitor the functioning of corporate and also guiding the interest of investors and creditors. With increasing awareness and access to information, investors do not depend on regulators to protect them. They are conscious of their rights and strive to maximize their wealth, so does a company. The key differences, with everything else being common, will be the ability to create self driven, self assessed, self regulated organization with a conscience. That ultimate is all about corporate governance in India and elsewhere.

In view of the above the importance of corporate governance in financial institutions can be well realized. Effective corporate governance practices are essential in achieving and maintaining public trust and confidence on the financial institutions, which are critical to the proper functioning of the institutions and economy as a whole. Poor corporate governance result into failure in financial institutions, which can pose significant public costs and consequences due to their potential impact on any applicable deposit protection systems and the possibility of broader macroeconomic implications, such as contagion risk and impact on payment systems. In addition, poor corporate governance can lead markets to lose confidence on the ability of financial institutions to properly manage its assets and liabilities, including deposits, which could in turn trigger a financial institutions run or liquidity crisis. Indeed, in addition to their responsibilities to shareholders, financial institutions also have a responsibility to their stakeholders.

II. CORPORATE GOVERNANCE: A CONCEPT

The concept of governance has been propounded by the most celebrated scholar of ancient India, Kuatilya. According to him, "an ideal king is one for whom in the happiness and well being of the subjects, lies the well being of the king, in the welfare of the subjects, is the welfare of the king, what is desirable and beneficial to the subjects and not his personal desires and ambitions, is desirable and beneficial for the king. He further elaborates that a king has a fourfold duty as raksha or protection, Vridhi or enhancement, palana or maintenance, yogakshema or safeguard. It is the duty of the king to protect the wealth of the state and its subjects, to enhance the wealth, to maintain and safeguard the interests of the subjects".

Corporate Governance involves a set of relationships between a company's management, its Board, its shareholders and other stakeholders. Corporate governance provides a principled process and structure through which the objectives of the company, the means of attaining the objectives and systems of monitoring performance are also set. Corporate governance is a set of accepted principles by management of the absolute rights of the shareholders as a true owner of the corporation and of their own rule as trustees on behalf of the shareholders. It is about commitment to values, ethical business conduct, transparency and makes a distinction between personal and corporate funds in the management of a company.

Corporate governance is traditionally defined as the system of laws, regulations and practices, which will promote enterprise, accelerate performance and ensure accountability. It stimulates for effectiveness in the performance and operations of a corporate. The effectiveness, in today's parlance, mean that business must run in a manner to enhance stakeholders' value, skewing radically from established enhancement of shareholders' value only and moving towards stakeholders' value maximization.

AMERICAN MANAGEMENT ASSOCIATION: Corporate governance is about how suppliers of capital get managers to return profits, make sure managers do not misuse the capital by investing in bad projects, and how shareholders and creditors monitor managers.

INTERNATIONAL CHAMBER OF COMMERCE: Corporate governance is the relationship between corporate managers, directors and the providers of equity, people and institutions who save and invest their capital to earn a return. It ensures that the board of directors is accountable for the pursuit of corporate objectives and that the corporation itself conforms to the law and regulations.

THE CORPORATE LIBRARY: The relationship between the shareholders, directors and management of a company, as defined by the corporate charter, bylaws, formal policy and rule of law

CONFEDERATION OF INDIAN INDUSTRY (CII): Corporate governance deals with laws, procedures, practices and implicit rules that determine the ability of the company to make managerial decisions visà- vis its claimants – in particular, its shareholders, creditors, customers, the State and employees.

III. CORPORATE GOVERNANCE AND FINANCIAL INSTITUTIONSS

Although globalisation of financial markets necessitates some basic international standards of corporate governance for financial institutions, it is also recognized that such uniform international standards may result in different levels of systemic risk for different jurisdictions because of differences in business customs and practices and institutional and legal structures of national markets. Each country will therefore need domestic regulations that prescribe specific rules and procedures for the governance of financial institutions that address national differences in political economic and legal systems while adopting international standards and principles.

Financial institutions are "special" as they not only accept and deploy large amount of uncollateralized public funds in fiduciary capacity, but they also leverage such funds through credit creation. The role of financial institutions is integral to any economy. They provide financing for commercial

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enterprises access to payment systems and a variety of retail financial services for the economy at large. The integral role that financial institutions play in the national economy is demonstrated by the almost universal practice of states in regulating the financial institutions industry and providing in many cases a government safety net to compensate depositors when financial institutions fail. The large number of stakeholders whose economic well being depends on the health of the financial institutions depends on implementation of appropriate regulatory practices and supervision. Indeed in a healthy financial institutions system the regulators and supervisors themselves are stakeholders acting on behalf of society at large. As regulators we do not act on behalf of shareholders or individual customers but on behalf of groups such as depositors' policyholders or pension fund members who rely on the continued solvency of regulated institutions for their financial security but who are themselves not well placed to assess financial soundness.

Financial institutions unlike insurance companies are highly leveraged entities and asset liability mismatches are an inherent feature of their business. Consequently, they face a wide range of risks in their day-to-day operations. Any mismanagement of risks by these entities can have very serious and drastic consequences on a stand alone basis which might pose a serious threat for financial stability. This dimension further strengthens our premise that effective risk management systems are essential for financial institutions and emphasise the need for these to be managed with great responsibility and maturity. Good corporate governance, therefore, is fundamental to achieve this objective.

CORPORATE GOVERNANCE IN FINANCIAL INSTITUTIONS

The issue of corporate governance in financial institutions, like any organization, needs to be addressed in regard to:

- ✓ Quality and concentration of ownership;
- ✓ Quality of Management (BoD)
- ✓ Prudential framework and
- ✓ The mechanism for effective oversight of Board of Directors.

A. QUALITY AND CONCENTRATION OF OWNERSHIP

The ownership issue in financial institution includes a few crucial matters that have been engaging our attention and a policy environment is being sought to be created that would confirm to the best principles of governance. Unique corporate governance challenges are posed where the ownership structure lacks transparency or where there is insufficient checks and balances on inappropriate influences of controlling shareholders. While there can be different views on the issue of concentrated ownership, there is clearly recognition that significant shareholders should pass the fitness and propriety tests.

B. QUALITY OF MANAGEMENT

Senior management consists of a core group of individuals responsible for the day to day management of the financial institutions – should have necessary skills and oversee line managers in specific business areas and activities consist of policies and procedures laid down by the Board.

Senior Management establishes effective system of internal controls.

C. PRUDENTIAL STANDARDS

The whole principle of capital regulation is that the owners will monitor if they have much at stake either in the form of capital or future profits. Hence the emphasis on capital adequacy. Similarly the need for prudential norms on income recognition and asset classification and provisioning is required because of the nature of financial institutions balance sheets-loan assets do not lend themselves to proper valuation. Appropriate accounting standards, connected and related party transaction regulations, risk based supervision enforcement of corporate governance rules are essential for promoting sound corporate governance. In fact the importance of corporate governance permeates the Core Principles for financial institutions Supervision against which we assess our practices.

D. BOARD OF DIRECTORS (8-PRINCIPLE)

These are principles of an effective corporate governance process in a financial institution:

- ✓ Board members should be qualified for their positions, have a clear understanding of their role in corporate governance and be able to exercise sound judgment about the affairs of the financial institutions.
- ✓ The board of directors should approve and oversee the financial institutions' strategic objectives and corporate values that are communicated throughout the organisation.
- ✓ The board of directors should set and enforce clear lines of responsibility and accountability throughout the organisation
- ✓ The board should ensure that there is appropriate oversight by senior management consistent with board policy.
- ✓ The board and senior management should effectively utilise the work conducted by the internal audit function, external auditors, and internal control functions.
- ✓ The board should ensure that compensation policies and practices are consistent with the institutions' corporate culture, long-term objectives and strategy, and control environment.
- ✓ The financial institutions should be governed in a transparent manner.
- ✓ The board and senior management should understand the operational structure, including where the financial institutions operates in jurisdictions, or through structures, that impede transparency (i.e. "know-your-structure").

Benefits of Best corporate governance practices in financial institutions:

- ✓ Increase efficiency of their activities and minimize risks;

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- ✓ Get an easier access to capital markets and decrease the cost of capital;
- ✓ Increase growth rate;
- ✓ Attract strategic investors;
- ✓ Improve the standards of lending;
- ✓ Protect the rights of minority shareholder and other counterparts;
- ✓ Strengthen their reputation and raise the level of investors and clients' trust.

IV. CONCLUSION

From the above discussion it is clear that practice of corporate governance not only enable the financial institutions to increase the efficiency and effectiveness but also bring transparency in the affairs of the organization. It is a means to promote business ethics and moral among the management of the organization that leads to protection of right of minority shareholders and enhance the faith and integrity of the investors towards the financial institutions.

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