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# Corporate Governance and Market Reaction with Reference to Banking Sector

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The thesis is mainly bases on the corporate governance practices in the banks and its market reactions i.e. impact on stock prices. This research work also shows the how good corporate governance practices help to banks in decreasing nonperforming assets and increasing the shareholders value.

This thesis is based on the deep study of previous studies on bank corporate governance, importance and objectives of corporate governance, benefits of sound governance and relation between corporate governance and stock market reactions etc.

**Overview of Corporate Governance**

"Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined."

*"By the Organization for Economic Co-operation and Development (OECD)"*

"Corporate governance is the system by which companies are directed and controlled by the management in the best interest of the shareholders and others ensuring greater transparency and better and timely financial reporting. The boards of directors are responsible for governance of their companies."

**What is Corporate Governance?**

"Corporate governance is needed to create a corporate culture of consciousness, transparency and openness. It refers to combination of laws, rules, regulations, procedures and voluntary practices to enable the companies to maximize the shareholders long-term value. It should lead to increasing customer satisfaction, shareholder value and wealth."

- Corporate governance is the system by which companies are directed and controlled.


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management and control of business, enables the Bank to maintain a high level of business ethics and to optimize the value for all its stakeholders. The objectives can be summarized as:

- To enhance shareholder value.
- To protect the interests of shareholders and other stakeholders including customers, employees and society at large.
- To ensure transparency and integrity in communication and to make available full, accurate and clear information to all concerned.
- To ensure accountability for performance and to achieve excellence at all levels.
- To provide corporate leadership of highest standard for others to emulate.

## Corporate Governance Practices in ICICI

### Vision

To be the leading provider of financial services in India and a major global bank.

### Mission

We will leverage our people, technology, speed and financial capital to:

- Be the banker of first choice for our customers by delivering high quality, world-class products and services.
- Expand the frontiers of our business globally.
- Play a proactive role in the full realization of India's potential.
- Maintain a healthy financial profile and diversify our earnings across businesses and geographies.
- Maintain high standards of governance and ethics.
- Contribute positively to the various countries and markets in which we operate.
- Create value for our stakeholders.

### Code of Commitment

ICICI Bank follows a voluntary Code, which sets minimum standards of banking practices when they are dealing with individual customers.

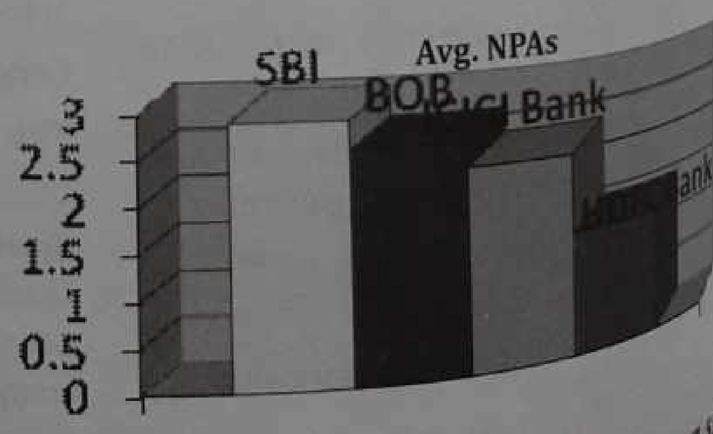
### Privacy Policy

ICICI Bank is strongly committed to protecting the privacy of its customers.

### Code of Conduct and Business Ethics

ICICI Group expects all its employees, officers and directors to act in accordance with high professional and ethical standards.

| | |
|---|---|
| SBI | 2.9 |
| BOB | 2.57 |
| ICICI Bank | 2.3 |
| HDFC Bank | 1.4 |



## Conclusions

The literature on corporate governance examines the efficacy of alternative structures of ownership and the boards of directors and various other governance structures. While there is increasing evidence of the failure of certain governance structures to control and motivate managers to increase firm performance, the empirical evidence to date is mixed and gives little coherent evidence for the shape of an optimal governance structure. One explanation is that existing theories have not been sufficiently complete to include all major determinants of good corporate governance.

Perhaps there will never be one optimal governance structure because no two firms, two markets, two legal regimes or two cultures are exactly the same, resulting in highly complex issue of corporate governance. Ultimately governance structure is determined by a combination of the above factors and their dynamics. A more likely and useful outcome of the on-going debate and research, perhaps, might be the increasing focus on shareholder interest and concerns, and identification of some widely accepted guiding principles, rather than trying to find some specific mechanisms which are universally applicable, for effective corporate governance.

We can conclude that there is direct impact of good governance on market price of securities in banking sector. Good governance helps in maintaining good relation with employees, customers, government and other stake holders. Basel norms have brought in paradigm shift in bank governance as it helps in maintaining transparency in each and every operation like compensation policy, auditing, insider trading etc.

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- It deals largely with the relationship between the constituent parts of a company –
  - The Directors,
  - The Board (and its sub-committees) and;
  - The Shareholders.
- Transparency and accountability are the most important elements of good corporate governance. This includes:
  - The timely provision by companies of good quality information;
  - a clear and credible company decision - making process;
  - Shareholders giving proper consideration to the information provided and making considered judgments.

The basic objective of Corporate Governance would be "enhancement of the long-term shareholders value while at the same time protecting the interests of other stakeholders."

**Overview of Bank Corporate Governance**

Effective corporate governance practices are essential to achieving and maintaining public trust and confidence in the banking system, which are critical to the proper functioning of the banking sector and economy as a whole. Poor corporate governance may contribute to bank failures, which can pose significant public costs and consequences due to their potential impact on any applicable deposit insurance 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 in the ability of a bank to properly manage its assets and liabilities, including deposits, which could in turn trigger a bank run or liquidity crisis. Indeed, in addition to their responsibilities to shareholders, banks also have a responsibility to their depositors.

From a banking industry perspective, corporate governance involves the manner in which the business and affairs of banks are governed by their boards of directors and senior management, which affects how, they:

- Set corporate objectives
- Operate the bank's business on a day-to-day basis
- Meet the obligation of accountability to their shareholders and take into account the interests of other recognized stakeholders
- Align corporate activities and behavior with the expectation that banks will operate in a safe and sound manner, and in compliance with applicable laws and regulations; and protect the interests of depositors.

**Basel Committee: An Introduction**

The Basel Committee on Banking Supervision is a committee of banking supervisory authorities which was established by the central bank Governors of the Group of Ten countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, Netherlands, Spain, Sweden, Switzerland, United Kingdom and the United States. It usually meets at the Bank for International Settlements (BIS) in Basel, Switzerland, where its permanent Secretariat is located.

**Basel II Committee Principles on Sound Corporate Governance**

**Principle 1**

***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 bank.***

**Principle 2**

***The board of directors should approve and oversee the bank's strategic objectives and corporate values that are communicated throughout the banking organization.***



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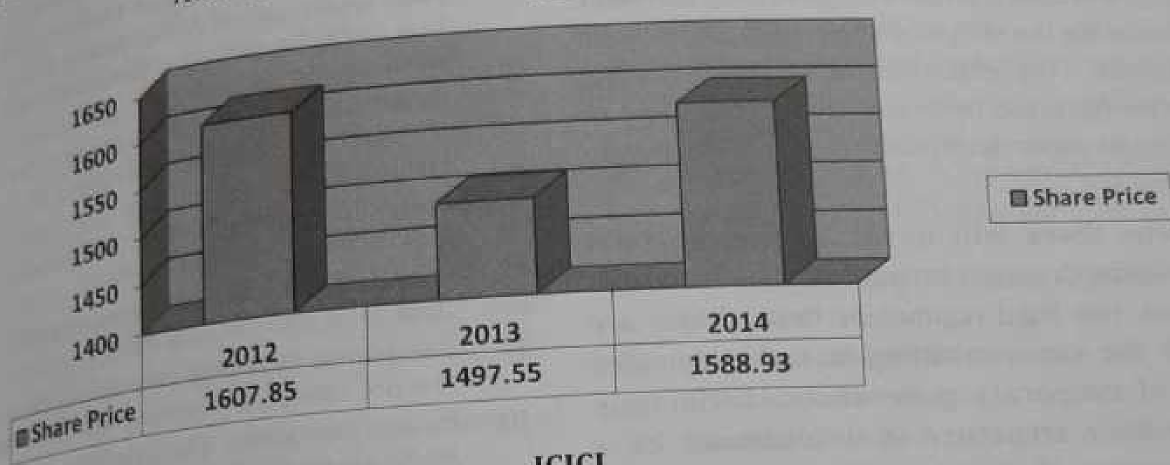
### Data Interpretation

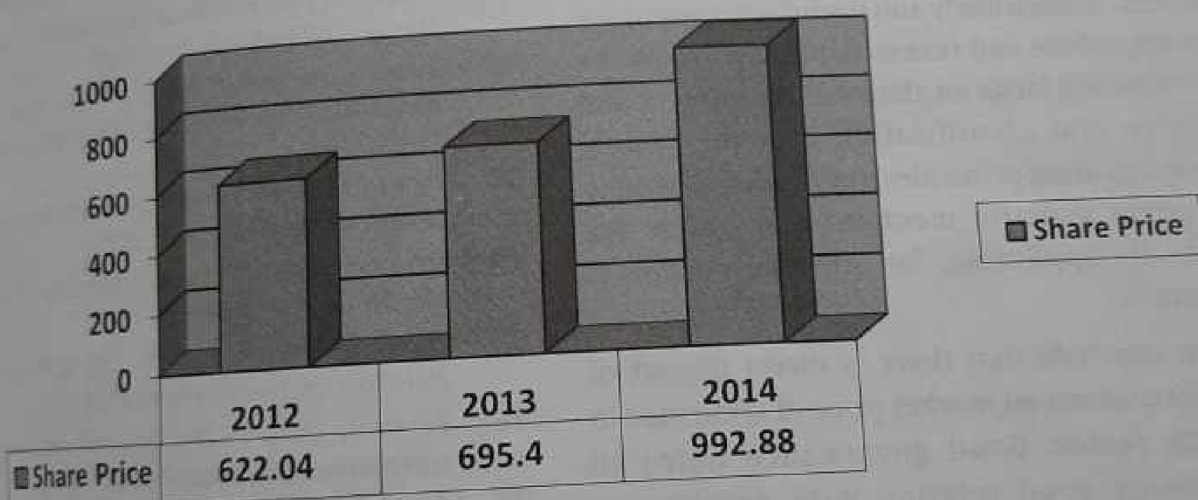
As the above figure is showing the data of Average NPAs all the banks which are included in my study. SBI is having the highest NPA amongst the other studied banks. It can be evaluated that SBI is largest banking institution of the country so close control is not possible as compare to other banks which are not having wide operations as SBI has. HDFC has best corporate governance strategy as the governance of HDFC is rated best and it can be shown by the lowest average NPA i.e. 1.4%.

**Average Share Price For the Year 2012, 2013 and 2014**

**SBI**




**ICICI**




### Discussion of Implications

- As per the study conducted, corporate governance is directly related with market reaction. A significant improvement in share price of ICICI. On the other hand, due to lack of good governance it can be seen the remarkable decrease in share price of SBI.
- Good governance also helps in maintaining good market goodwill of the bank. As ICICI bank is not having the sound governance so at the time of recession, there were rumors in the market that ICICI can be bankrupt.
- Better governance helps in maintaining good relation with stakeholders and stakeholders are backbone of the company.
- Basel committee principle also helps in carrying smooth operations of the banks and helps in managing risks, helps in auditing etc.

Principle 3

The board of directors should set and enforce clear lines of responsibility and accountability throughout the organization.

Principle 4

The board should ensure that there is appropriate oversight by senior management consistent with board policy.

Principle 5

The board and senior management should effectively utilize the work conducted by the internal audit function, external auditors, and internal control functions.

Principle 6

The board should ensure that compensation policies and practices are consistent with the bank's corporate culture, long-term objectives and strategy, and control environment.

Principle 7

The bank should be governed in a transparent manner.

Principle 8

The board and senior management should understand the bank's operational structure, including where the bank operates in jurisdictions, or through structures, that impede transparency (i.e. "know-your-structure")

### Description of the Problem

The study on "Corporate Governance and Market Reaction in Special respect of Banking Sector" is being conducted to get the solution of following problems of banking companies:

- Lack of Transparency in Banking operations
- Many banking companies do not follow proper code of conduct and governance
- Problem of insider trading by internal people
- Lack of proper accounting principles

### Objectives of The Study

The objectives of my study on "*Corporate Governance and Market Reaction in Special respect of Banking Sector*" are as follows:

- To know, how effective governance effects the stock prices of the banks
- To know the impact of corporate governance on operations of banking companies
- To conduct comparative performance analysis of Nationalized and Privatized banks
- To know the importance of audit committee, board structures and role of independent directors in governing the banks
- To know the importance of corporate governance in banks
- To know the Basel committee norms

### Database

#### *Target*

- Banks (Nationalized and Private)
- The research is based on secondary Data Collection
- The researcher will target the banks

### Method of Data Collection

#### *Secondary Data*

Secondary data is the data that already exist which has been collected by some other person or organization for their use and is generally made available to other researchers. Sources of secondary data include websites, trade associations, journals, books etc.

### Corporate Governance Practices in SBI

### The Bank's Philosophy on Code of Governance

State Bank of India is committed to the best practices in the area of corporate governance, in letter and in spirit. The Bank believes that good corporate governance is much more than complying with legal and regulatory requirements. Good governance facilitates effective