**Journal of IMS Group**
Vol. 14, No. 2, July-December 2017, pp. 61-68

# Corporate Governance Practices and Bank Performance and Value using Special Index for Banks: A Case Study of ICICI Bank

**S.Sandhya and Dr. Neha Parashar**

**Abstract**

*Corporate Governance is a complex topic because there is no clear basis as to what constitutes perfect Corporate Governance. Undoubtedly, the success of a company largely depends on sound governance mechanisms. This paper attempts to study the relationship of corporate governance practices and financial success of a firm. The aim here is to know whether there is any relationship of Corporate Governance Practices to the profitability and value of firm. The governance needs of banks are different from the other industries. The reason for such a difference is the assets and liabilities composition of a bank. ICICI Bank is considered to be the most successful private sector bank in India in terms of technology and innovations. A Corporate Governance Index for bank is prepared and it is used as a measure to know the extent of Governance Practices of ICICI Bank. The total score of the index is used to find the correlation of the Governances practices of ICICI bank and its financial performance in terms of financial indicators viz; ROA, NIM, PBV and Tobin's Q. A stronger correlation is found to be existing between Corporate Governance Index and ROA and NIM and a weak correlation of Corporate Governance index is observed with PBV and Tobin's Q*

***Keywords**: Corporate Governance practices, Corporate Governance Index, Corporate Governance Rating, Private bank, financial performance.*

## INTRODUCTION

"Adventure is the life of commerce, but caution is the life of banking." — Walter Bagehot, author of Lombard Street: A Description of the Money Market.

Banking is the epicentre of an economy's development. Banks are the lifeblood to keep the world economy on the run by money circulation and providing credit. History is evident that telephones, oil companies, railroads, automobiles and technology firms; all the industries developed after banks. They paved the way for creating opportunities by providing necessary credit and operating system to the other industries. History is also

**S.Sandhya**
Assistant Professor
Aurora's PG College, Hyderabad and Research Scholar, RK University
Rajkot, Gujarat

**Dr. Neha Parashar**
Faculty
IBS Business School
Pune, Maharastra

testimony to the fact that the same banks can also be the reason for debacle in an economy. Lack of timely flow of funds, operational discrepancies, no proper check on the internal activities, and failure of system to name a few are few of the reasons for collapse of banking at a particular point of time. There will be ripple effect of banks failure on other industries and on the overall economy. Owing to the fact that they have a very high impact on the successful functioning of economy, banks have to be cautiously managed and this is possible when there are strong practices and policies to ensure proper internal management namely Corporate Governance.

Corporate Governance is the name given to the practices, policies, rules, checks that are recognized and followed in carrying out basic to complex decisions and activities in a company. Board of Directors have a significant role in a company and must ensure that they are following good corporate governance practices. There is ambiguity as to what constitutes good corporate governance. There are numerous studies that have recognized that it's just not the Board of Directors but other elements also that contribute towards this end.

**Theoretical Backdrop**

A lot of research is being taken up on the issue of Corporate Governance (CG). The reason for such an increasing amount of research may be due to the operational failures of corporates and scandals that are coming into light. Zheka (2005) argued that by applying theory of value creation, relation can be established between corporate efficiency and corporate value and observing the relation between CG and firm efficiency is a meaningful study. Kohli and Saha (2008) used panel data regression method to study the impact of Corporate Governance mechanisms on valuation of 30 companies in FMCG and IT sectors in India. It was found that there is strong relationship between CG and market value of firm, among all elements, shareholders rights and value creation for stakeholders surfaced as important for valuation. Chhaochharia and Grinstein (2007) conducted an event study of the announcement of Sarbans-Oxley Act, and many changes to the U.S stock exchange regulations and the consequent effect on firm value in terms of returns. It was found that firms that are less compliant earned higher positive abnormal return than the firms with high compliance and also that some regulations were detrimental to the small firms. Sehgal and Mulraj (2007) studied the evolution of the concept of CG in India, various reforms that have emerged towards this end and the key unresolved issues in them. It was recognized that Indian Government and regulators have recognized the need to improve CG and that India has been observing global best CG practices. They also argued that corporate compliance at both macro level and micro level need a lot of improvement so that companies maintain a sense of responsibility towards all the stakeholders. Pant and Pattanayak (2007) studied the effect of insider trading on the firm value measured in terms of Tobin's Q. It was observed that there is a non linear and non-monotonic relationship between insider trading and firm value and concluded that higher insider trading is beneficial to the firm and also economy as it maximises the shareholders wealth. And also opined that the major governance problem in India is conflict between insider and outsider investor. Bhagat *et al* (2008) studied the effectiveness of CG indices in forecasting the firm performance and understand the subsequent implications for regulatory agencies from such study. It was found in this study that there is no one best measure for CG and it all depends on firm specific situation and context. They argued that CG indices are not perfect measures to draw conclusions regarding firm performance and value and cautioned investors and regulators in using CG indices as performance measure. Bebchuck *et al* (2009) analyzed the relative significance of each and every provision in the twenty-four provisions followed by the Investor Responsibility Research Center (IRRC) to relate them with the firm value. They identified six entrenching provisions to be negatively correlated with firm value and the remaining eighteen provisions either reduced firm value or negative abnormal returns suggesting uncorrelation.

Marishetty (2011) made a unified framework of CG by integrating four components namely; investors, managers, directors and law & regulations. The views of NR Narayan Murthy, founder member of Infosys, were also incorporated to bridge any gap between principle & practices. It was found that, in Infosys any of the four components were not important at all but the emphasis was on value system, ethics and integrity and that Infosys competed with better employee and customer engagement. Sen (2011) studied 50 listed companies with the aim of determining to what extent the Indian listed companies disclosed CG practices as per revised Clause 49 of Listing Agreement of SEBI. It was concluded that size of the company was a significant determinant and also there is a good amount of gap in the quality and quantum of disclosure; both mandatory and non-mandatory requirements.

Levine (2003) reviewed the literature available to study the government policies to enhance CG in banks and concluded that instead of relying on government regulators, it is necessary to strengthen the ability and incentives of private investors to improve governance in banks. Grove *et al* (2011) analysed multiple dimensions of CG practices of public commercial banks in U.S. It was found that CG factors better explain financial performance than the loan quality. Evidence was presented that regulations of banks have significant influence on the effectiveness of CG practices. Aebi (2012) investigated whether the presence of Chief Risk Officer (CRO) in a bank's executive board and the CRO reporting directly to CEO related to a better bank performance during 2007-08 financial crises. The bank's performance was measured in terms of buy-and-hold returns and ROE. It was found that there are significantly higher stock returns and ROE during crises when CRO directly reported to board that CEO and that the standard CG variables were insignificant or negatively related to banks performance during crises. Deb (2013) examined CG attributes in banking sector in India and how the banks follow these CG practices. It was revealed that the CG in Indian Banking was not a new thing but the effectiveness of CG practices is not known to majority of the banking professionals. Preethi and Ramesh examined the CG disclosure levels of five nationalised banks in India. A comparative analysis was conducted and it was found that there is no uniformity in the disclosure levels in banks. Tuteja and Nagpal (2013) made an effort to develop a CG index for commercial banks in India to evaluate the quality of CG practices. Hence, a CG index was prepared keeping in view clause 49 of SEBI's Listing Agreement. Adhikar (2014) studied the growth and crises in Banking and Financial Institutions. The aim here was to examine regulatory provisions of CG in Nepalese Banking and Financial Institutions with reference to Basel principles. It was revealed that in spite of several regulatory reforms, Nepalese financial institutions faced failures and suggested for a self managed code of conduct to disclose board governance and other CG related issues.

## Research Gap

From the above review of literature it can be understood that researchers made efforts to know what practices are part of corporate governance and what constitutes good corporate governance. Efforts were also made to know the correlation between Corporate Governance and the financial performance of firms as there is little research on corporate governance in bank and the correlation between CG practices and banks financial performance.

## Objective of the Study

This paper is an attempt to study the CG practices in commercial banks in India. An endeavour has been made to know the correlation between CG practices of ICICI Bank and its financial performance.

## Methodology and Analysis

ICICI Bank Ltd is perhaps the first Indian Commercial bank to adopt latest technology in banking. This bank revolutionized the concept of online banking in India. ICICI Bank is also one of the top ten banks in India in terms of market capitalization and has consistently been a component in BANKEX (banking index) of BSE India. Such a success for any firm is not possible without a strong management and governance. Yet, ICICI Bank does not have a CG rating.

The present study is about CG practices and financial performance of ICICI Bank Ltd. To measure financial performance Return on Assets (ROA), Net Interest Margin (NIM), Price to Book Value (PBV) and Tobin's Q are used. ROA and NIM are accounting variables and PBV and Tobin's Q are market related variables.

To study the CG practices of ICICI Bank Ltd an index has been prepared which is according to the Companies Act, 2013 and revised Clause 49 of Listing Agreement of SEBI. The Corporate Governance Index (CGI) prepared by Tuteja and Nagpal (2013) for banks has been taken as base. The index covers all the possible elements that are part of CG practices in bank. A total of 39 elements have been identified which are categorized under seven sub criteria Board of Directors, Audit Committee, Remuneration Committee, Nomination Committee, Risk Management, Related Party Transactions and Disclosures. Each element will be given a score of one if adhered and zero if not adhered and some elements like exceeding single borrower limit will be given a negative one if exceeded and zero if not exceeded. The maximum score that can be earned is 34 points. Data for ten years for the period 2007- 2016 is collected and then a correlation of CG index and ROA, NIM, PBV and Tobin's Q will be found. The data is collected from the annual reports of the bank by doing content analysis and from the ICICI bank official website.

**Interpretation of Table 1**

The above table shows the calculation of CGI of ICICI Bank Ltd for a period of 10 years from 2007 to 2016. The criteria in the index have been selected based on the present

**Table 1: Showing the Calculation of Corporate Governance Index and Performance Variables of ICICI Bank for the Period 2007-2016**

| Basis | Criteria | Point | Year | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
| Board of Directors | Board consists of not more than 12 members | -1 or 0 | -1 | -1 | -1 | -1 | 0 | 0 | 0 | 0 | 0 | -1 |
| | Chairman of the Board is non-executive | 1 or 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | Proportion of independent directors is equal to or more than 50% | 1 or 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | CEO and Chairman are separate | 1 or 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | Minimum 4 board meetings are held | 1 or 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | Maximum number of meetings do not exceed 11 | -1 or 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| | Declassified board | 1 or 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| | Independent directors are trained | 1 or 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 1 | 1 |
| | Independent directors meet separately | 1 or 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Independent director serving more than 9 years on the board | -1 or 0 | -1 | -1 | -1 | -1 | -1 | -1 | -1 | -1 | -1 | -1 |
| | Appointment of lead independent director | 1 or 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| | Multiple directorship in more than 7 companies | -1 or 0 | -1 | -1 | -1 | -1 | -1 | 0 | -1 | -1 | -1 | -1 |
| Audit Committee | Chairman of Audit Committee is Independent | 1 or 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | Minimum of 2/3 rd Directors are independent | 1 or 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | Meets at least 4 times a year | 1 or 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | Independent members meet seperately | 1 or 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| | External Auditor provides only audit services | 1 or 0 | 1 | 1 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| | Internal Auditors report directly to Audit Committee | 1 or 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Remuneration Committee | Remuneration Committee Exists | 1 or 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | All are non-executive members | 1 or 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | Chairman is Independent | 1 or 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | Meets at least 2 times a year | 1 or 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | Performance evaluation of independent directors | 1 or 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 1 | 1 |
| | Performance Based incentive to CEO | 1 or 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Nomination Committee | Nomination Committee Exits | 1 or 0 | 0 | 0 | 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | 2/3rd are independent | 1 or 0 | 0 | 0 | 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | Chairman is Independent | 1 or 0 | 0 | 0 | 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | Meets at least two times in a year | 1 or 0 | 0 | 0 | 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Risk Mana-gement | RM plan exists | 1 or 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | Single Borrower limit has not been exceeded (-1) | -1 or 0 | 0 | 0 | 0 | -1 | -1 | 0 | 0 | 0 | 0 | -1 |
| | Credit allocation procedure exists | 1 or 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Related Party Transactions | Prior approval of Audit Committee required for RPTs | 1 or 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| | Approval of shareholders by a special resolution for divestment of material subsidiary | 1 or 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Disclosures | RPTs disclosed | 1 or 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | Any non-compliance and penalties and strictures thereto | 1 or 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | Ratio of remuneration of each director to the median of employees remuneration | 1 or 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 1 | 1 |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | succession plan | 1 or 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| | Criteria for remuneration to non executive directors disclosed | 1 or 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 1 | 1 |
| | Whistle blowing policy exists | 1 or 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | Total maximum Score | 34 | 16 | 16 | 15 | 18 | 19 | 21 | 20 | 20 | 24 | 22 |
| ROA | | | 1.09% | 1.12% | 0.98% | 1.13% | 1.34% | 1.50% | 1.70% | 1.78% | 1.86% | 1.49% |
| NIM | | | 2.19% | 2.22% | 2.40% | 2.50% | 2.60% | 2.73% | 3.11% | 3.33% | 3.48% | 3.49% |
| PBV | | | 3.16 | 1.84 | 0.75 | 2.06 | 2.33 | 1.69 | 1.81 | 1.96 | 2.27 | 1.53 |
| Tobin's Q | | | 1.152 | 1.098 | 0.967 | 1.15 | 1.18 | 1.088 | 1.1 | 1.119 | 1.158 | 1.066 |

regulatory requirements. The highest CGI score is 24 in the year 2015 and the lowest is 15 in the year 2009. It can be observed that most of the elements have scored consistently throughout the study period. There are many elements that scored same point all through the ten years indicating no change and the important ones to be noted among them are independent directors serving more than nine years on the board, Chairman of the board being non-executive director and proportion of independent directors being more than 50%.

The number of directors on the board has exceeded 12 in five years and the bank exceeded single borrower statutory limit in three years. The scoring related to Audit Committee and Remuneration Committee is unchanged all throughout the study period. Nomination Committee is observed to be formed from the year 2010, and this particular element scored consistently from the year 2010.

The above table also shows the measures of financial performance and value of firm; ROA, NIM, PBV and Tobin's Q for the ten years. NIM is consistently increasing whereas ROA is highest in the year 2015 (1.86%) and lowest in the year 2009 (0.98%) and Tobin's Q is also highest in the year 2015 (1.158) and lowest in the year 2009 (0.967). PBV is highest in the year 2013 (2.33) and lowest in the year 2009 (0.75). It can to be noted that CGI is also highest in the year 2015 and lowest in the year 2009. There have been some major regulatory improvements in India around the years 2013-2014, so the highest CGI score and performance may be attributed to such changes. It may also be recollected that there was major governance debacle in the year 2008 of Satyam-Mytas which affected the whole economy and also led to some immediate regulatory reforms. This might be the cause for lowest financial performance and also CGI in the year 2009.

**Interpretation of Table 2**

The above table shows the correlation between the CGI score of ICICI bank and each of the financial variables. CGI is taken as independent variable and ROA, NIM, PBV and Tobin's Q are taken as dependent variables. There is high correlation of CG with ROA and NIM than PBV and Tobin's Q. Lowest correlation can be found with PBV.

**Table 2: Showing Correlation between CG and Financial Variables**

| | |
|---|---|
| Correlation between CG and ROA | 0.878 |
| Correlation between CG and NIM | 0.883 |
| Correlation between CG and PBV | 0.069 |
| Correlation between CG and Tobin' Q | 0.321 |

## FINDINGS AND CONCLUSION

The above figures (1, 2, 3 and 4) show the graphical representation of correlation of CGI with each of ROA, NIM, PBV and Tobin's Q.

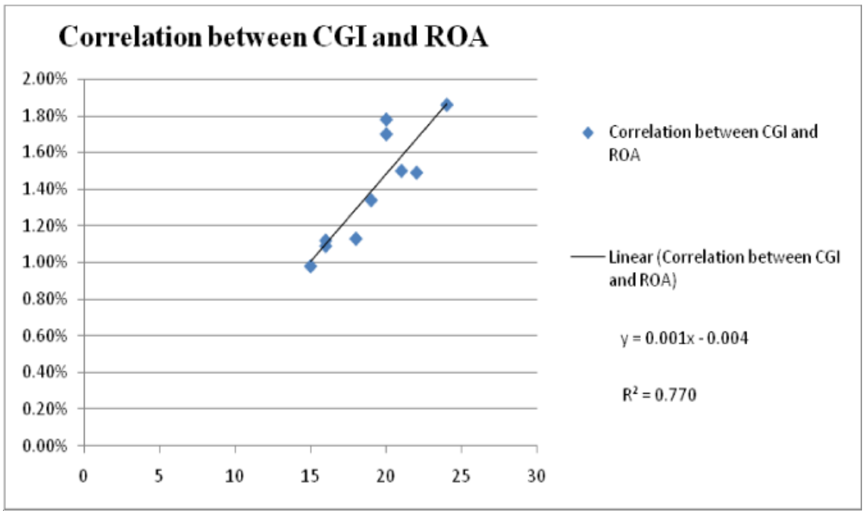


Figure 1: Correlation between CGI and ROA

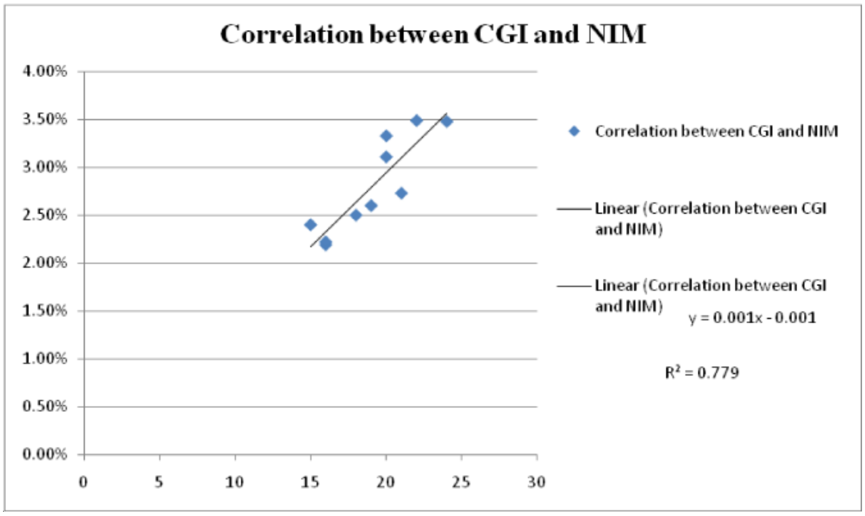


Figure 2: Correlation between CGI and NIM

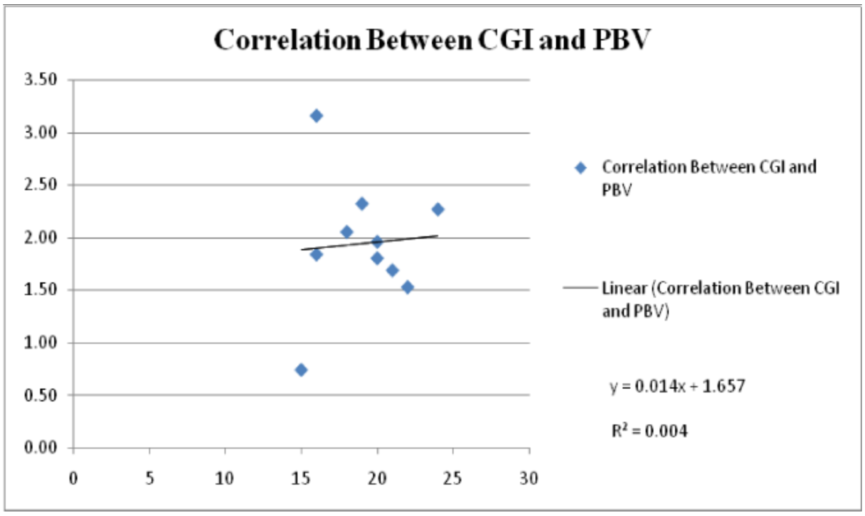


Figure 3: Correlation between CGI and PBV

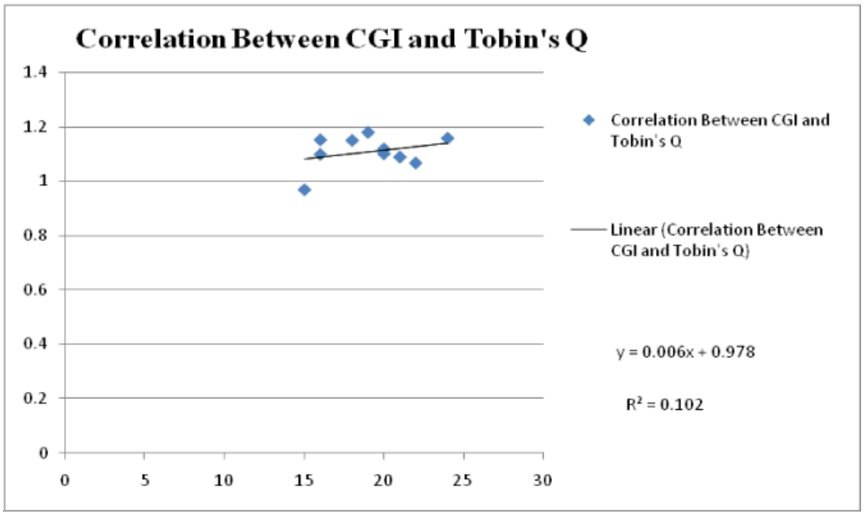


**Figure 4: Correlation between CGI and Tobin's Q**

The best fit line is also shown in each of it exhibiting linear relation of CGI and the dependent variables. In all the four graphs the best fit line is rising from left to right which shows positive correlation. Close relationship of CGI can be found with ROA and NIM as the points in the Scatter diagrams (Figures 1 and 2) are close to the best fit line and the lines are also steep. Whereas from Figures 3 and 4, the best fit lines are slanting and also that the point are farther indicating weak correlation and also there are few outliers in Figure 3.

R square indicates the impact of independent variable on the dependent variable. There is higher R square in Figure 1 and 2 (0.770 and 0.779), very low in figure 4 (0.102) and lowest in figure 3 (0.004). This means that CGI has highest impact on ROA and NIM and lowest impact on PBV.

From the above analysis it can be concluded that there is stronger correlation between CGI and accounting variables; ROA and NIM and weaker correlation between CGI and market related variables; PBV and Tobin's Q. The best fit line and R square hint that CGI as a tool can be used to study the effect of corporate governance practices of ICICI Bank on its financial performance. The stronger positive correlation of CGI with accounting variables suggest that sound governance practices leads to better internal management which in turn leads to better financial performance. The weak but positive correlation of CGI with market related variables advocate that the market players do not give much importance to the corporate governance practices of ICICI bank. But it has to be understood that unless the bank delivers good financial returns, the market will invest in the shares of the bank.

From the consistently increasing CGI score, it can be examined that ICICI bank has been improving its corporate governance practices. Whenever there have been changes to the law, the bank has adopted the mandatory practices of governance. But it has left out few non mandatory practices like approval of external auditors before entering RPTs among others. The bank must try to pursue those governance practices also apart from statutory ones. It must try to proactively inculcate good governance practices to deliver highest shareholder value.

## REFERENCES

1. Adhikari, P. (2014), Corporate Governance Practices: Crises And Challenges In Banking Industry In Nepal, *Abhinav National Monthly Refereed Journal Of Research In Commerce & Management*, 3(10), pp. 51-59

2. Aebi, V., Sabato, G. and Schmid, M. (2012). Risk Management, Corporate Governance, And Bank Performance In The Financial Crisis, *Journal Of Banking & Finance*, 36, pp. 3213–3226
3. Bebchuk, L., Cohen, A., and Ferrell, A. (2009). What Matters in Corporate Governance?, *The Review of Financial Studies*, 22(2), pp. 783-827
4. Bhagat, S., Balton, B. and Romano, R. (2008). The Promise and Peril of Corporate Governance Indices, *Columbia Law Review*, 108(8), pp. 1803-1882
5. Chhaochharia, V. and Grinstein, Y. (2007). Corporate Governance and Firm Value: The Impact of The 2002 Governance Rules, *The Journal Of Finance*, 67(4), pp. 1789-1825
6. Deb, R. (2013). Corporate Governance Practices In Indian Banks, *Journal Of Business Management & Social Sciences Research (JBM&SSR)*, 2(5), pp. 36-50
7. http://www.sebi.gov.in/commreport/corpgov.pdf (accessed on 24th December 2016)
8. https://www.icicibank.com/aboutus/annual.page (accessed on 30th December 2016)
9. Kohli, N. and Saha, G. C. (2008). Corporate governance and valuations: Evidence from selected Indian companies, *International Journal of Disclosure and Governance,* 5(3), pp. 236–251
10. Marisetty, V. B. (2011). Corporate governance survey: A holistic view for altruistic practice, *IIMB Management Review*, 23, pp. 30-38
11. Pant, M. and Pattanayak, M. (2007). Insider Ownership and Firm Value: Evidence from Indian Corporate Sector, *Economic and Political Weekly*, 42(16), pp. 1459-1467
12. Sehgal, A. and Mulraj, J (2007). Corporate Governance In India: Moving Gradually From A .Regulatory Model To A Market-Driven Model - A Survey, *International Journal Of Disclosure And Governance,* 5(3), pp. 205–235
13. Sen, A. (2011). Corporate Governance in India: Clause 49 of the Listing Agreement, *Jm International Journal Of Management Research*, 1(2), pp. 162-171
14. Tuteja, S. and Nagpal, C. S. (2013). Formulation Of Corporate Governance Index For Banks In India, *Research Journal Of Finance And Accounting*, 4(7), pp. 153-160
15. Zheka, V. (2005). Corporate Governance, Ownership Structure and Corporate Efficiency: The Case of Ukraine, *Managerial and Decision Economics*, 26(7), pp. 451-460