

Corporate Governnace and its Impact: A Banks Specific Heterogenity Study

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ARTICLE INFO

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Dates:

Received: 20-01-2023

Accepted: 15-03-2023

Published: 25-07-2023

Keywords:

Brdsz, Brdind, Frbm,
Capar, Roe and
Corporate Governance.

How to Cite:

Asif, A.I., Sharma,
L.K. (2023) Corporate
Governnace and
its Impact: A Banks
Specific Heterogenity
Study. DME Journal of
Management, 4(1), 38-44.
doi: 10.53361/dmejm.
v4i01.06

Abstract

The Indian banking sector plays and contribute very crucial contribution in the growth and development of the country But if it is applied a good corporate governance practices, a good Corporate Governance bring change in the organization in term of releasing the responsibilities toward the shareholders, the present paper reveal the effect of CG on the performance of selected Indian banks with the help of data collected from 2007-08 to 2016-17 for a sample of eight selected banks of India. The data was analyzed with the help of Panel Data Regression and Pearson correlation along with SPSS, Eviews and Gretl , the present research has consider return on equity (ROE) as performance variable while BRDSZ, BRDIND, FRBM and CAPAR were used as variables of corporate governance, the research has concluded that there is no relationship of board size, frequency of board meetings, and capital adequacy ratio but positive significant impact of board independency on return on equity was revealed.

INTRODUCTION

The companies' act 2013, clause 49 of SEBI regulation and norms of international Basel committee provide guidelines for banks and Financial Institutions. The Banking Sector of India has always been consider an impact player for the development of the Indian economy due to its wide reached and diversified product and services but Banking Sector of India lagged behind due to issues related with the loan disbursement policy, scams and increasing numbers of frauds which is merely a cause of failure in good corporate governance practices. An honest approach in the corporate governance of banks is a real challenge due to large numbers of stakeholders and increasing use of technology in the banking operation. The Banking sector of India had not done good progress over the last couple of years which includes immense increased in the amount of Non-Performing Assets (NPA) especially of public sector Banks. Corporate governance ensures proper governance of business followed by complying all governance norms

Prescribed by regulatory body. A good corporate governance practices ensure the benefits of all interested parties including shareholders, customers and employees.

The term corporate governance has gained much more attention since last few years. Corporate governance is a complex process as it deals with overall control of activities in a corporation, due to financial irregularities, frauds and global financial crises corporate governance has gained importance in academic and the corporate over the past few years, the work of good corporate governance is to improve the reliability of the company among different stakeholders through meeting legal requirements. A systematic and control banking sector of a country ensure economic development of the country, So Indian Banking Sector need a strong corporate governance system due to its operation globally and discharge of answerability toward different stakeholders.

The core objective of this paper is to analyses the effect of corporation across selected banks followed by banks specific heterogeneity and ranking of banks in relation of impact of independent variables on dependent variables.

The primary motive of present study is to know the effectiveness of CG in relation of the Performance of selected Indian banks.

The present research is organized as follows-section two refers to the literature review, section three relates with the objectives and research methodology and at last section four conclude the analysis part.

Literature Review

Mousa F. Al Manaseer and laad Issa Sartawi et.al (2012) has used pooled data and ols estimation to analyze the impact of CG Dimension and the performance of fifteen banks of Jordan, the authors with the help of pooled data and OLS estimation over 15 Banks of Jordan for +the period of 2007-09 revealed that there is a positive relationship between foreign ownership and members of board members on Jordanian bank's performance while on other side size of board and separation of CEO & Chairman shown negative relationship with the performance of Jordanian banks. The study for the period from 2005-2011 Alshenafi Beyene Fanta1, Kelifa Srmolo Kemal and Yodit Kassa Waka (2013) concluded the BRDSZ and existence of Audit committee revealed negative impact on bank's performance which

was measured by ROE and ROA, on the other hand size of bank and Capital adequacy ratio as an external CG mechanism had positive effect on Bank's performance Aruwa, Musa Mohammed et.al (2014) concluded as there is no connection between capital adequacy ratio and Performance of selected Nigerian Banks. Anshuman Kumar and Yatin Nihalani (2014) applied Regression iteration on the data of fourty Indian Banks to analyze the effect of CG parameters like Board size, numbers of meetings, executive overlap, busy directors and women directors on Bank's performance with ROA, ROE, return on long-term funds,earnin per shares and book value as performance indicators. The study revealed that the BOD's had positive significant impact on return on long-term funds but others corporate governance parameters had no significant impact on the performance of Banks. Ahmed Al-Baidhani (2014) has studied the correlation between internal corporate governance mechanism and its impact on the seven Arabian peninsula countries, he used ROA and ROE for measuring the Banks performance on the basis of board size, ownership structure, Bank size, Bank age and audit functions were taken as variable or the tool of corporate governance mechanism, resultant he concluded that corporate governance and bank profitability are significant. The frequency of board meetings per year along with the age of bank have positively significant relationship with ROE. On the other hand independent directors in the board and size of the board has shown significantly negative effect on ROA along with age of bank and board committee depicted positive effects on profit margin and shows negative effect on profitability. Samson Ogege and Tarila Boloupremo (2014) has analyzed the connection of board size and performance of Nigerian banks, which included proportion of non-executive directors and its impact on the Banks performance, the two authors also considered CG disclosure index as one of the variable for the study, on the other hand financial performance of Banks were depicted on the basis of ROA and ROE, lastly study has shown positive relationship between CG variables and performance of banks. Karam Pal Narwal and Sonia Jindal (2015) has considered number of board members, numbers of members in



audit committee, frequency of meetings of Board, remuneration of executives and nonexecutive directors as Independent Variables to analyze their impact on the profitability of Indian textile sector after considering the data from 2009-10 to 2013-14. The data was analyzed with the help of correlation OLS regression model which indicated the negative association of audit committee with the profitability while director's remuneration was strongly positive association with profitability on the other hand BRDSZ, FRBM and Non-executive Directors did not show relationship with profitability. Muhammad Akhyar Adna et al. (2015) studied the efficiency of Malaysian listed Banks due to corporate governance variables by using panel data analysis, the study concluded that smaller the board size higher the percentage of block ownership caused improved result in banks performance. An empirical study was conducted with the sample size of eight Tunisian Banks by Chenini Hajer and Jarboui Anis (2016) with the hypothesis that there is no set standard of corporate governance that can affect the performance of financial market in general and Banks in particulars, there were numbers of such study already been done in developed countries due to this gap researchers took developing countries for the study, during study the researcher had considered ROA and ROE as performance variables, at the end researcher concluded that there is no effect of CG on the market value and accounting Performance of the Banks. C.P Abdul Gafoor, V. Mariappan and S. Thyagarajan (2018) has found that Board size along with board independent were positively significant with bank performance in their study over thirty six Banks in India covering duration from 2001-2014 while no significant relationship between Bank performance and if CEO and Chairman exist separately. Uzma Basher (2018) has found insignificant relationship between board size along with institutional ownership and ROA, ROE & EPS while Frequency of Board meeting was found insignificant with Return on Assets & Earning per share and negatively significant with return on assets. Ahmad Al-Baidani (2014) in their research found positively significant relationship between board meetings along with banks age and ROE, while negative and significant relationship was

seen between board independency & banks size and ROA.

OBJECTIVE & RESEARCH METHODOLOGY

The present study is a kind of empirical based two fold study analysis including individual study along with the study emphasize on overall effect of CG on selected banks performance. Secondary data was analyzed which was extracted from Annual Reports and prowess Data base for 2007-08 to 2016-17. The researcher has used Size of board (BRDSZ), independency in board (BRDIND), Capital Adequacy ratio (CAPAR), and numbers of board meetings (FRBM) as Independent Variables while return on equity (ROE) as dependent variables/ performance variables of banks. The data has been analyzed to know the cross sectional effect of the variables of C.G on the Performance of Selected banks with the help of Panel Data Regression and Pearson Correlation followed by Durban Watson Test for serial Correlation and Variance Inflation Factor for multi collinearity issue

Hypothesis to be Tested

H₀₁: "There is no significant impact of BRDSZ on ROE across selected Banks in India"

H₀₂: "There is no significant impact of BRDIND on ROE across selected Banks in India"

H₀₃: "There is no significant impact of CAPAR on ROE across selected Banks in India"

H₀₄: "There is no significant impact of FRBM on ROE across selected Banks in India".

The panel regression model for testing Hypothesis:

$$(ROE)_{i \times t} = \alpha_i + \beta_1 (BRDSZ)_{i \times t} + \beta_2 (BRIND)_{i \times t} + \beta_3 (CAPAR)_{i \times t} + \beta_4 (FRBM)_{i \times t} + \mu_i + \varepsilon_{i \times t}$$

Research Analysis

The analysis in term of relationship between dependent and independent variables were assessed with the help of Pearson Correlation Coefficient.

MULTICOLLINEARTY RESULT

Correlation between Dependent and Independent variables

Table.1 clearly showing coefficient correlation between BRIND and BRDSZ both are independent variables with 0.842186 which is not under threshold limit of 0.7 which may lead to the problem of collinearity due to which variance inflation factor (VIF) was calculated to find out the culprit variables. The result of correlation between dependent and independent variables are also shown as BRDSZ, BRIND, CAPAR and FRBM is negatively correlated with ROE.

Variance Inflation Factor

The collinearity problem was solved with the help of V.I.F, as per Table 2 all values are within threshold limit of 10 then there will be no collinearity problem that arises between two independent variables i.e BRDSZ & BRDIND and doesn't affect result.

Results of Panel Diagnostic Test

There are three steps were involved in deciding the most favorable techniques for model among three choices – Pooled OLS, Fixed Effect and Random Effect model, The Null Hypothesis given in table 3 concluded that random effect model is favorable for ROE.. In this model null hypothesis has been checked by applying f-test, breusch pagan test and hausman Test for the comparison of different method. The p-values at 5% level of significance have been used as parameter for accepting and rejecting the null hypothesis. If p-value is less than 5% Level of significance then null hypothesis is rejected and vice versa for accepting of hypothesis.

It is concluded that random effect model is favorable for ROE model.

Table 1: correlation matrix

Variables	Brdsz	Brind	Capar	Frbm	Roe
BRDSZ	1				
BRIND	0.911175	1			
CAPAR	-0.12219	-0.17823	1		
FRBM	0.13116	0.17113	-0.41652	1	
ROE	-0.111176	-0.055277	-0.040851	-0.032628	1

Table 2: Collinearity Statistics

Dependent variable: ROE	Collinearity Statistics	
	Tolerance	VIF
(constant) BRDSZ	.279	4.350
BRDIND	.264	4.416
CAPAR	.603	1.322
FRBM	.578	1.324

Sources: SPSS Output

Regression Analysis- ROE model based on random effect model: Findings.

In Table 4 the interpretation of the result regarding the effect of CG on ROE through random effect model the most favourable after comparing with fixed effect and Pooled OLS model.

Pooled OLS, Fixed Effect and Random Effect Model Using 80 observation, Included 8 Cross Sections units

Length of Time Series = 10

Dependent variables: ROE

Robust (HAC) standard Error

According to above table 4 the result has shown that value of R² and adjusted R² of Random Effect Model are most appropriate to discuss Regression Model which represent ROE as dependent variable. Actually table 4 has shown the Relationship between Independent variables and Dependent Variables by using fixed effect, pooled ols and random Effect model but interpretation of result is done on the basis of random effect model due to its suitability for the model applied. Table 4 showing that the value of R² (0.481475) on the basis of fixed effect model that 48% of variation on ROE found due to selected Independent Variables in Model-2 while other of 52% variation is caused might be due to non-selected variables in model 2. In same model-2 on the basis of value of R² (0.027574) through pooled ols model indicating that only 2% effect on ROE is caused by selected variables while 98% effect May be caused by non-selected variables. Further in the same model through random effect model it was



Table 3: Summary of Panel diagnostic test

Panel diagnostic test for roe model.					
Test	Models	Null hypothesis	Value of p at 5% level of significance.	Result	Inferences
F-Test	Pooled OLS Vs Fixed Effect	Pooled OLS is favourable rather Fixed Effect Model.	1.92697e-007	Rejected	fixed effect model is appropriate.
breusch Pagan Test	Pooled OLS Vs random effect model.	Pooled OLS is favourable rather random Effect Model	6.9631e-011	Rejected	Random EffectModel is Appropriate.
hausman Test	Fixed Vs Random Effect Model	random Effect Model is favorable rather Fixed Effect Model.	0.599334	accepted	random effect Model is Appropriate.

Finally, Random Effect Model is More Appropriate and Consistent for ROE Model.

Table 4: Regression Analysis

Variables.	Pooled ols model	Fixed effect model	Random effect model
Constant	(22.3610) *0.0519	(3.60472) 0.8160	(6.62603) 0.6428
BRDSZ	(-0.622104) 0.5339	(-0.234324) 0.6477	(-0.259910) 0.5660
BRDIND	(0.404087) 0.6883	(0.643369) *0.0787	(0.492617) *0.0979
CAPAR	(-0.270154) 0.4679	(0.134990) 0.7147	(0.152759) 0.7117
FRBM	(-0.120536) 0.6035	(0.629394) 0.2960	(0.400329) 0.2755
R ²	0.027574	0.481475	0.031616
adj r ²	-0.024289	0.397596	-0.020031
F-Statistics	0.270842	5.740115	0.612163
P-value	0.887803	0.00002	0.655166

found that the value of R² (0.031616) indicated that 3% effect on ROE caused by variables selected in the model while remaining 97% caused due to variables not selected .

Board Size (BRDSZ)

As per table 4 the coefficient of board size (BRDSZ) is negative in pooled ols model, random effect model and fixed effect model and also showing insignificant or we can say negatively insignificant with return on equity and the null hypothesis is accepted that there is no significant impact of BRDSZ on ROE across selected Banks.

Board Independency (BRDIND)

The null hypothesis is rejected because the coefficient of BRDIND found positively significant that indicates no relationship between BRDIND and ROE.

Capital Adequacy Ratio (CAPAR)

The fixed and random effect model has shown coefficient of CAPAR as positive and insignificant but pooled ols has shown negatively insignificant due to which null hypothesis is accepted and concluded that no impact of CAPAR on ROE.

Frequency of Board Meetings (FRBM)

In Fixed Effect and Random Effect Model the coefficient of capital adequacy ratio has shown positive and insignificant relationship but negatively insignificant in pooled ols model which revealed that the Null Hypothesis of no Significant Impact of FRBM on ROE has accepted and Found there is no Significant Impact of FRBM on ROE.

Effect of BRDSZ on ROE

The comparison among selected Banks on the basis of impact of independent variables on return on equity has been analyzed through ranking, Table 5 showing Bank specific heterogeneity to know the Impact of BRDSZ and its impact On ROE on studied banks and no Impact of BRDSZ on ROE of hdfc, sbi, icici, kotak Mahindra and bob because all have Negative Corresponding Values but on the other

Table 5: Banks specific heterogeneity for the impact of BRDSZ on ROE

Banks	Cross sectional effect		Cross sectional effect	
	Fixed Effect	Rank	Random Effect	Rank
Hdfc	-7.512930		-6.636959	
Sbi	-502488		-0.236930	
Icici	-2.214619		-1.863457	
Axis	4.88138	2	4.443266	2
Kotak mahindra	-1.191700		-1.204304	
Indusind	2.276808	3	1.854216	3
Yes bank	5.800808	1	4.986247	1
Bob	-1.537258		-1.342079	

hand YES bank has highest Impact of BRDSZ on ROE along with AXIS banks at second and IndusInd banks at last in term of impact of BRDSZ size on ROE.

Effect of BRDIND on ROE

Banks specific heterogeneity is Analyzed in the way that effect of independency of board on return on equity through ranking by applying Fixed and Random Effect model, Table 6 cleared that YES Bank remain at top and shows that a highest effect of BRDIND, AXIS bank at second and IndusInd bank at third while HDFC, SBI, ICICI KotakMahindra and BOB has no significant impact due to their negative corresponding values.

Effect of CAPAR on ROE

Table 7 cleared that there is no impact of Capital Adequacy ratio on return on equity of hdfc, sbi,

Table 6: Bank Specific Heterogeneity for the Impact of BRDIND on ROE

Banks	Cross Sectional Effect		Cross Scetional Effect	
	Fixed effect	Rank	Random effect	rank
Hdfc	-7.387179		-6.615526	
Sbi	-0.884839		-0.590012	
Icici	-2.444080		-2.0691117	
Axis	4.983726	2	4.454962	2
Kotak Mahindra	-0.909326		-0.955053	
Indusind	2.402056	3	2.039600	3
Yes bank	5.951580	1	5.198860	1
Bob	-1.711938		-1.463714	

Table 7: Effect of CAPAR on ROE

Banks	Cross sectional effect		Cross sectional effect	
	Fixed effect	Rank	Random effect	Rank
Hdfc	-7.517183		-6.715545	
Sbi	0.085696	4	-0.038337	
Icici	-2.360892		-2.020017	
Axis	5.110081	2	4.542804	2
Kotak Mahindra	-1.796575		-1.461280	
Indind	2.272712	3	1.965842	3
Yes Bank	5.423047	1	4.917353	1
Bob	-1.216887		-1.190820	

Table 8: Banks specific heterogeneity - impact of FRBM on ROE

Banks	Cross sectional effect		Cross sectional effect	
	Fixed effect	Rank	Random effect	Rank
Hdfc	-6.429466		-6.196899	
Sbi	-1.762097		-0.959544	
Icici	-1.292997		-1.486810	
Axis	5.225728	2	4.602517	2
Kotak Mahindra	-0.526891		-0.818791	
Indnd	2.479153	3	2.057729	3
Yes Bank	7.542553	1	5.971159	1
Bob	-5.235984		-3.169361	

icici , kotak Mahindra, icici and bob and has shown negative values while yes bank depicted the highest impact along with axis bank at Second and IndusInd banks at Third place. The result was analyzed by applying fixed and random effect model but the conclusion was made through random effect model because it was found best favorable model.

Effect of FRBM on ROE

No significant impact of FRBM on ROE of hdfc, sbi, icici, kotak Mahindra and bob was found as per table 8 due to their negative values while yes bank has shown highest impact along with axis bank at second and IndusInd bank at Third. In this study the heterogeneity among banks is also analyzed by applying Fixed and Random effect model while the conclusion was drawn through random effect model due to its suitability.



CONCLUSION

The present research revolves around to indicate the influence of C.G on the performance of selected banks through ROE as performance indicator. It has been observed that only BRDIND as one of the variable of corporate governance variable held responsible for the performance of ROE across selected banks and found at 10% level of significance. On the other hand in comparative analysis of selected banks on the basis of effect of C.G variables in the case of ROE model it has been found that YES bank is at first rank, axis bank at second and indusind bank at third in way of effect of BRDSZ, BRDIND, CAPAR and FRBM on ROE and remaining banks has no effect of any independent variables on their ROE.

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