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A STUDY ON THE IMPACT OF CORPORATE GOVERNANCE ON NON-PERFORMING ASSETS OF SELECTED PUBLIC AND PRIVATE SECTOR BANKS IN INDIA

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ABSTRACT:

The Banking Sector plays a pivot role in building the economy of a country through its various financial services. These financial services sometimes become Non-Performing Assets (NPA) when borrowers fail to repay. An increase in Non-Performing Assets directly affects the financial performance of the banks. Hence the recovery process of loans needs to be monitored and controlled, thereby increasing the performance of the banks. This study attempts to bring out the impact of the corporate governance disclosure index on Non-Performing Assets (NPA) in the banking sector in India. This study uses secondary data collected from the annual report and director's report of the selected banks for a period of five financial years from 2014-2015 to 2018-2019. Regression analysis using SPSS is performed to analyses and it reveals that the impact of corporate governance disclosure index on the percentage of Net non-performing and percentage of gross non-performing asset is insignificant in the Indian banking sector as a whole but shows significance in the case of Percentage of Net non-performing asset in private sector banks.

Keywords: NPA, corporate governance and regression

1. INTRODUCTION

The banking sector plays a fundamental role in building the economy of any country. It is considered to be the backbone of the Indian economy too by providing various financial services to the end-users. One of the biggest threats and hurdle faced by the Indian banking industry year by year is an increase in the Non-performing assets (NPA). Banks lend the deposits collected from their depositors, which make it imperative that the depositor's interest and savings are safeguarded. Banks are accountable for the deposits made and the risks involved in managing the same. A loan portfolio that is considered to be banks main asset is perceived to be opaque to outsiders

In an Inaugural speech dated Nov 6 2019 delivered in Amrut Mody School of Management by Mr., Shaktikanta das, Governor, RBI stated that "some of the internal challenges faced by the public sector banks, and their governance could easily be identified as a central concern. In fact, many of the problems that currently seem to affect the public sector banks such as the elevated levels of a non-performing asset, capital shortfalls, frauds and inadequate risk management can mostly be related to the manifestation of underlying corporate governance issues." In addition to that he added, "the role of independent Boards in fostering a compliance culture by establishing the proper systems of control, audit and distinct reporting of business and risk management has been found wanting in some public sectors banks leading to a build-up of non-performing assets and the fact remains that a strong corporate governance culture, with a focus on transparency and accountability, has to percolate from a strong Board which sets the example by leading."

"Increase in Non-performing Assets can also be considered as a sign of poor corporate governance S.Sandhya (2019)."Net Non-performing Asset is considered as one of the key determinants of corporate Governance practices (Sujoy Kumar Dhar, Pema Lama, 2019). Hence from the above literature, it is understood that Non-performing Assets (NPAs) affects the capital and weakens the financial strength of Banks. Factors impacting the recovery process of Non-performing Assets need to be studied taking both internal and external factors. This study attempts to know the impact of corporate governance on Non-performing Assets of selected public and private sector banks listed in the Indian stock exchanges.

CORPORATE GOVERNANCE

The principles of OECD states that "Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders and it provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined." In the revised principles of the Basel committee, corporate governance helps to promote public confidence and raised the safety parameters of the banking system. Basel Committee also stresses the importance of risk governance, strong boards and committees ineffective overall control of Banks in the Corporate Governance framework.

The banking perspective of Corporate Governance is basically the manner in which the board and senior management govern its objective and day to day banking operations aligning with the shareholder's interest by complying with the laws and regulation in protecting the interest of the depositors with required various safety measures.

Poor adherence to corporate governance may lead to the bank's failure (OECD, 2006). Failure of a bank has serious effects on the effectiveness of the financial stability of an economy. This makes the importance of corporate governance in banks is different in comparison to any other companies adherence (Prof.Sumedha Tuteja1* Dr C.S. Nagpal, 2013).

In India, RBI and SEBI control and regulate the corporate governance mechanism in Banks.RBI governs and implements the corporate governance mechanism in Banks and all listed banks controlled and regulated by SEBI (clause 49 of the listing agreement). Over two decades various committees have amended and revised guidelines on corporate governance Disclosure practices in India.

NON-PERFORMING ASSET

One of the important financial services done by the bank is lending loans to borrowers. The borrowers are companies, individuals or any organization. The loans are banks assets as it earns the interest, but sometimes there may be default in the payment of interest as well as principal amount by the borrowers to the banks. The loans that fall under this category become non-performing assets. "Non-performing assets are an asset that ceases to earn income in the form of interest for the principal and default in the payment of principal loan amount." In either case, the banks may not fully or partly recover due to borrower inability or poor economic condition to pay back.

RBI defines a Non-Performing Asset as "An assets, including leased assets, becomes non-performing when it ceases to generate income for the banks" through its Master Circular No DBR. No. BP. BC.2/21.04.048/2015-16 dated July 1, 2015, paragraph 2.1.1." As per the guidelines of RBI, an account is classified as a Non-Performing Asset only when the interest due and charges on that account is not paid within 90days from its due date. Non-Performing Asset reduces the profits and increases the capital; hence it is very important for banks to identify the assets changing into Non-Performing Assets.

Types of Non-Performing Asset

A. Gross Non- performing Asset

Gross NPA refers to the sum of all the loans that have been defaulted by the borrowers which are held in banks' book of accounts. Gross Non-Performing Asset consists of all nonstandard assets such as sub-standard, doubtful and loss assets. Gross Non-Performing Asset is calculated in the following ratio:

Gross Non-performing assets Ratio = Gross Non-performing assets / Gross Advances

B. Net Non-Performing Asset

Net Non-Performing Assets are those non-performing assets in which provisions are deducted by the Banks, where the actual loss to the banks is shown. Net Non-Performing Asset is calculated using the following:

Net Non-performing assets = Gross Non-performing assets–Provisions/Gross Advances – Provisions

2. REVIEW OF LITERATURE

Various researches have been done on different factors influencing Non-Performing Asset on the national and international level. The study of Sujoy Kumar Dhar and Pema Lama (2019) on Corporate Governance Disclosure Score and its perspectives with respect to the Indian Banking Sector reveals that there is an inverse relationship between corporate governance disclosure score and net Non-Performing Asset and Correlation coefficient between corporate governance disclosure score and net Non-Performing Asset is significant. Amos Layola M, Sharon Sophia & Anita M (2016), expressed that banks with Good corporate governance value the risk in lending and provisioning of loan loss, as they increase their profitability and efficiency. Saseela Balagobei (2020) examined the influence of corporate governance on Non- performing loans of listed banks in Srilanka and found that the board's activities have a significant influence on Non-performing loans whereas board size, board independence and CEO duality has no significant influence on Non-performing loans. Manash Kumar Sahu, Narayana Maharana & Suman Kalyan Chaudhury (2017), found that "Managing bad loans and controlling them at the lowest level has become paramount important for the banking industry in recent years and no corporate governance measures seem to be fruitful in controlling the NPA in both public and private sector banks". They examined the impact of corporate governance practices on Non-Performing Assets Management in Indian Public and Private Sector Banks and found an insignificant relation between weighted CG score and net NPA ratio. Chaudhury & Devi Prasad Misra (2019), studied the corporate governance practices and their impact on non-performing assets of selected commercial banks in India and found that there is no relation and impact of corporate governance practices on NPAs in public and private sector banks. Paul Aondona Angahar& Simon Kolawole Mejabi (2014) examines the impact of corporate governance variables on non-performing loans of Nigerian deposit money banks and concluded that there is no relation between board size, board composition, power separation and composition of the audit committee on non-performing loans. TerzungweNyor and Simon Kolawole Mejabi, (2013) examined the impact of corporate governance variables on Non-performing loans of Nigerian banks and found that no significant impact of corporate governance shown on their NPA.

3. RESEARCH METHODOLOGY

3.1 SCOPE OF THE STUDY

Corporate governance practices in the Indian banking sector is examined to draw inference regarding its relationship and its impact on the percentage of Gross Non-Performing Asset (GNPA %) and percentage Net Non-Performing Asset (NNPA %). The scope of the study is limited to Indian public and private sector banks listed in stock exchanges. Earlier researches have shown mixed results regarding the relationship between corporate governance practices and their effect on the non-performing asset. But many researchers and financial professionals have reported that adherence to proper corporate governance principles may have positive relationships in managing the non-performing asset. Hence through this paper, an attempt is taken to understand the relationship between the corporate governance disclosure index and its impact on the non-performing asset.

3.2 OBJECTIVE OF THE STUDY

- To examine the impact of Corporate Governance index score on the percentage of Gross Non-Performing Asset.
- To examine the impact of Corporate Governance index score on the percentage of Net Non-Performing Asset.
- To explore the relationship between corporate governance practices and the percentage of Gross Non-Performing Asset in Indian public and private sector banks.
- To explore the relationship between corporate governance practices and the percentage of Net Non-Performing Asset in Indian public and private sector banks.

3.3 SOURCES OF DATA

The study uses a simple random sampling method in selecting the five private and five public sector banks in India. Secondary data is sourced from website, journals and articles. The period ofstudy is five financial years from 2014-15 to 2018-19.

The study selected five public sector banks and five private sector banks namely:

PUBLIC SECTORS BANKS	**PRIVATE SECTOR BANKS**
SYNDICATE BANK	YES BANK
UNION BANK	KOTAK MAHINDRA BANK
BANK OF INDIA	CITY UNION BANK
BANK OF BARODA	SOUTH INDIAN BANK
PUNJAB NATIONAL BANK	KARUR VYSYS BANK

3.4 VARIABLES EMPLOYED

DEPENDENT VARIABLES: Percentage of Gross Non-performing Asset and percentage of Net Non-performing Asset are considered as the dependent variable. The Percentage of Gross Non-performing Asset and percentage of Net Non-performing Asset are calculated as follows:
Percentage Gross NPA = (Gross NPAs / Gross Advances)*100
Percentage NPA = (Gross NPAs – Provisions / Gross Advances – Provisions)*100
The data related to the Percentage of Gross Non-performing Asset and percentage of Net Non-performing Asset is obtained from the annual report and director's report of the concerned bank, available in the web portals.

INDEPENDENT VARIABLE: In this study, the corporate governance disclosure index is considered an independent variable. Corporate governance disclosure is based on the parameters of SEBI listing Agreement, clause 49. "1" is given for each parameter if the banks disclose in the annual report, otherwise"0". Scale for Measuring Corporate Governance disclosure score is given in annexure.

3.5LIMITATIONS OF THE STUDY

This study is limited to selected public and private sector banks in India listed in the National and Mumbai stock exchanges, India.

4. DATA ANALYSIS AND INTEPRETATION

The tables below shows the GNPA%, NNPA% and CGI score of selected public and private sector banks for the period of five years.

Table-A: GNPA%, NNPA% and CGI score of Public sector banks

BANKS	VARIABLES	2019	2018	2017	2016	2015	Avg.
SYDICATE	GNPA%	11.37	11.53	8.50	6.70	3.13	**8.246**
	NNPA%	6.16	6.28	5.21	4.48	1.90	**4.806**
	CGI	0.85	0.82	0.86	0.89	0.77	**0.836**
UNION	GNPA%	14.98	15.73	11.17	8.70	4.96	**11.108**
	NNPA%	6.85	8.42	6.57	5.25	2.71	**5.96**
	CGI	0.88	0.83	0.82	0.81	0.84	**0.834**
BANK OF INDIA	GNPA%	15.84	16.58	13.22	13.07	5.39	**12.82**
	NNPA%	5.61	8.26	6.90	7.79	3.36	**6.384**
	CGI	0.75	0.75	0.75	0.77	0.72	**0.746**
BANK OF BARODA	GNPA%	9.61	12.26	10.46	9.99	3.72	**9.208**
	NNPA%	3.33	5.49	4.72	5.06	1.89	**4.098**
	CGI	0.88	0.83	0.83	0.81	0.82	**0.832**
PNB	GNPA%	15.50	18.38	12.53	12.90	6.55	**13.172**
	NNPA%	6.56	11.24	7.81	8.61	4.06	7.656
	CGI	0.98	0.95	0.97	0.97	0.97	**0.967**

Table-B: GNPA%, NNPA% and CGI score of Private sector banks.

BANKS	VARIABLES	2019	2018	2017	2016	2015	Avg.
YES	GNPA%	3.22	1.28	1.52	0.76	0.41	**1.438**
	NNPA%	1.86	0.64	0.81	0.29	0.12	**0.744**
	CGI	1.00	0.95	0.95	0.94	0.98	**0.964**
KOTAK	GNPA%	2.14	2.22	2.59	2.36	1.85	**2.232**
	NNPA%	0.75	0.98	1.26	1.06	0.92	**0.994**
	CGI	0.91	0.89	0.90	0.91	0.97	**0.917**
CUB	GNPA%	2.95	3.03	2.83	2.41	1.86	**2.616**
	NNPA%	1.81	1.70	1.71	1.53	1.30	**1.61**
	CGI	1.00	0.89	0.87	0.83	0.87	**0.894**
SOUTHINDIAN	GNPA%	4.92	3.59	2.45	3.77	1.71	**3.288**
	NNPA%	3.45	2.60	1.45	2.89	0.96	**2.27**
	CGI	0.91	0.92	0.89	0.84	0.86	**0.884**
KVB	GNPA%	8.79	6.56	3.58	1.30	1.85	**4.416**
	NNPA%	4.98	4.16	2.53	0.55	0.78	2.6
	CGI	0.94	0.90	0.86	0.86	0.84	**0.879**

4.1Relationship between Non-Performing Assets and Corporate Governance Index of Indian banking sector

Table 1: Regression Analysis on GNPA %, NNPA % AND CORPORATE GOVERNANCE DISCLOSURE INDEX in Indian Banking Sector

Result of regression using SPSS						
Variables	**R**	**R^2**	**Unstandardized B**	**Co-eff SE**	**F**	**Sig**
GNPA%	0.47	0.22	-32.644	21.268	2.356	0.163
NNPA%	0.38	0.15	-14.092	11.831	1.419	0.268

The above table 1, shows that R^2 =0.22 indicating that 22% variance over the dependent variable GNPA% whereas 15% variance over NNPA% (R^2 =0.15). The result of regression table shows that there is no significance between the dependent variables (GNPA% &NNPA %) and independent variable (CGI) at 5% significance level and shows a negative relationship.

4.2 Relationship between Non-Performing Assets and Corporate Governance Index of Public Sector Banks.

Table 2: Regression Analysis on GNPA %, NNPA % AND CORPORATE GOVERNANCE DISCLOSURE INDEX in Public Sector Banks

Result of regression using SPSS						
Variables	**R**	**R^2**	**Unstandardized B**	**Co-eff SE**	**F**	**Sig**
GNPA%	0.19	0.036	5.225	15.53	0.113	0.75
NNPA%	0.45	0.2	7.898	9.036	0.764	0.44

The above table 2, shows that R^2=.036 indicating that 03% variance over the dependent variable GNPA% and 2% variance over NNPA% (R^2 =0.2). The result of ANOVA table shows that there is no significance between the dependent variables (GNPA% & NNPA %) and independent variable (CGI) at 5% significance level.

4.3Relationship between Non-Performing Assets and Corporate Governance Index of Private Sector Banks

Table 3: Regression Analysis on GNPA %, NNPA % AND CORPORATE GOVERNANCE DISCLOSURE INDEX in Private Sector Banks

Result of regression using SPSS						
Variables	**R**	**R^2**	**Unstandardized B**	**Co-eff SE**	**F**	**Sig**
GNPA%	0.875	0.765	-28.416	9.098	9.755	0.052
NNPA%	0.886	0.785	-20.389	6.165	10.938	0.045

The above table 3, shows that R^2 =0.765 indicating that 76 % variance over the dependent variable GNPA% and 78% variance over NNPA% (R^2 =0.785). The result of regression table shows that there is significance between the NNPA % and CGI at 5% significance level and negative relationship.

5. CONCLUSION

In this study, the main objective is to know the impact and relationship between corporate governance and non-performing asset in selected public and private sector banks in India. To know the impact, the study uses regression analysis and the result reveals that there is no significance between corporate governance and non-performing assets but the percentage of the net non-performing asset of private sector banks have a negative relationship and it is significant with corporate governance index whereas public sector banks show insignificance, may be due to the other factors and variables affecting non-performing asset. Hence, there is a scope for further studies with regards to other variables or factors affecting the non-performing asset. In addition to the above results, the private sector bank's with higher corporate governance disclosure index scores shows lesser non-performing asset percentage.

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ANNEXURE – I

Scale for Measuring Corporate Governance disclosure score
(Source of Information: Annual Reports)

I	1	**STATEMENT OF PHILOSOPHY**
II		**BOARD OF DIRECTORS**
	2	Composition
	3	Category of directors
	4	Attendance of director
	5	Attendance of last AGM
	6	No., of board of directors or committee is member/chairperson
	7	No., of board meeting with date
	8	Director's interse
	9	Shares held by directors
	10	Familiarization of independent Directors
III		**AUDIT COMMITTEE**
	11	Brief description of terms of ref.,
	12	Composition
	13	Name of members and chairperson
	14	Meetings and attendance during the yr.
IV		**NOMINATION &REMUNERATION COMMITTEE**
	15	Brief description of terms of ref.,
	16	Composition
	17	Chairperson and member
	18	Meetings and attendance during the yr.
		Remuneration policy (2014-15)
		Details of remuneration to all the directors, as per format in main report (2014-15)
	19	Performance evaluation
V		**Remuneration of Directors**
	20	Transactions of non-executive
	21	Criteria for making payment
	22	Disclosures with respect to remuneration
VI		**SHAREHOLDER COMMITTEE**
	23	Name of non-executive director
	24	Name & designation of compliance officer
	25	No., of shareholder's complaint received
	26	No., not solved to the satisfaction of shareholder
	27	No., of pending complaints
VII		**GENERAL BODY MEETINGS**
	28	Location & time of last three AGM
	29	Special resolution passed in last three AGM
	30	Special resolution passed thru postal ballot
	31	Person conducted the postal ballot
	32	Special resolution proposed thru postal ballot
	33	Procedure for postal ballot
VIII		**MEANS OF COMMUNICATION**
	34	Quarterly results
	35	Newspaper wherein result published
	36	Any website where displayed
	37	Whether official release
	38	Presentation to investors or analyst

IX		**GENERAL SHAREHOLDER INFORMATION**
	39	AGM- date & time
	40	Financial year
	41	Dividend payment date
	42	Name & address of stock exchange
	43	Stock code
	44	Market price data
	45	Performance in comparison to broad-based
	46	Director's report if securities suspended from trading
	47	Registrar & share transfer agents
	48	Share transfer system
	49	Distribution of shareholding
	50	Dematerialization shares and liquidity
	51	Outstanding GDR/ADR/warrants/or any convertible instruments, conversion date and likely impact on equity
	52	Commodity price risk or foreign exchange risk and hedging activities
	53	Plant locations
	54	Address for correspondence
X		**DISCLOSURE**
	55	Disclosure relating to related party transactions
	56	Details of non-compliance by the listed entity, penalties, strictures imposed on the listed entity by stock exchange(s) or the board or any statutory authorities
	57	Vigil mechanism, whistle blower policy and affirmation to the audit committee
	58	Details of compliance with mandatory requirement
	59	Web link
	60	Web link with related party transaction
	61	Disclosure of commodity price risk and commodity hedging activities
XI	62	**Non-compliance of corporate governance report**
XII	63	**Adoption of part E of schedule II**
XIII	64	**Disclosure of compliance with corporate governance requirement**
XIV	65	Sexual harassment (2018-19)