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Corporate Governance in Public Sector Banks – Issues and Challenges

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Prologue

The unique characteristics of financial intermediaries in the financial sector and their special relationship with different stakeholders in the economy have been posing a special challenge to standard governance practice. Questions of transparency, incentive conflicts, and agency conflicts in the corporate sector are compounded by greater opacity, government ownership, and regulation of financial institutions. In addition, the costs of poor governance in the financial sector are much more widespread than are those of individual corporations. Because financial intermediaries are the repositories of household wealth, their losses or failures can lead to large systemic and social costs. Governance in the financial sector assumes further importance also because of its greater dominance as well as the magnitude of its repercussions on the economy, in case of their failure. Its governance has both a public and a private dimension – in the case of the former, the direct or indirect, full or partial ownership and regulatory aspects of the government, and in the case of the latter, control of private financial institutions and the regulator. The dominance of the public sector in the financial sector adds fuel to these problems. As in most of the emerging economies, in India this sector has a close and complex relationship with the financial sector and often plays several roles simultaneously: those of the regulator of financial institutions, an owner of financial institutions, a market participant, a fiduciary agent, and sometimes an agent that directly intervenes in the operations of the market.

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Among the different constituents of the financial sector, banking institutions have a larger stake in both the aspects of its functioning ie glory and agony. As most of them in India are state-managed institutions, poor governance in them certainly exerts a distorting influence on public sector rules and institutions. The channeling of the scarce savings of society to wasteful borrowers deprives sound companies of credit and thus acts as a drag on economic growth. Further, unintelligent excessive lending leads to laying the foundation of a future crisis when an economic shock renders many borrowers unable to repay in time or repay at all. As the principal financial intermediary and as a critical component of any economy, bank failures can adversely affect individual wealth while possibly leading to systemic losses.

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The importance of banks to national economies is underscored by the fact that banking is virtually universally a regulated industry and that banks have access to government safety nets. It is of crucial importance therefore that they have strong corporate governance. Against this background the paper attempts to examine the importance of governance in banks in general and in the Indian public sector banks (PSBs) in particular (Section 1). This paper also endeavors to identify the grey areas which hinder the effective governance in PSBs (Section 2) and gives some prescriptions for the issues (Section 3).

Section 1

Corporate Governance: In Search of a Definition

The discussion on governance has absorbed most of the economies for more than a decade. Travelling through the pre-1992 American discussions on disassociation of power and money (emanating from the Watergate Scandal), post-1992 *Cadbury Report* on governance codes and OECD principles (1998 & 1999), corporate governance has not yet settled at any universally accepted definition. Because there are so many varying views on what corporate governance is as a definitive product, there is no globally applicable definition of corporate governance (Barnier, 2001). In fact, the very definition of corporate governance stems from its organic link with the entire gamut of activities having a direct or indirect influence on the financial health of corporate entities (Kamesam, 2002). The *Cadbury Report* (1992) simply described corporate governance as "the system by which companies are directed and controlled." It can be confined to the "Corporate Governance Tripod," that is, the relationship between shareholders, directors and management. An increasing number of definitions refer to the fact that many other groups have an interest in the company (Van den Berghe, De Ridder, 1999). It is "... an umbrella term that includes specific issues arising from interactions among senior management, shareholders, boards of directors, and other corporate stakeholders" (Cochran, 1988). It is "the system by which business entities are monitored, managed and controlled" (RBI, 2001a). It is "a set of relationships between a company's management, its board, its shareholders, and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently" (OECD, 1999). In its broadest sense, governance refers to the "range of institutions and practices by which authority is exercised to satisfy the interest of all the stakeholders including society" and its meaning is shaped by the specific value system prevalent in the country.

No matter what view of the corporate objective is taken, effective governance ensures that boards and managers are accountable for pursuing it. The role of effective corporate governance is of immense significance to society as a whole. In the first place it promotes efficient use of scarce resources both within the organization and the larger economy. Secondly, it makes the resources flow to those sectors or entities where there are efficient production of goods and services and the return is adequate

enough to satisfy the demands of stakeholders. Thirdly, it provides a broad mechanism for choosing the best managers to administer the scarce resources. Fourthly, it helps the managers to remain focused on improving performance, making sure that they are replaced when they fail to do so. Fifthly, it pressurizes the organization to comply with the laws, regulations and expectations of society. And last but not least, it assists the supervisors in regulating the entire economic sector without partiality and nepotism.

Governance in banks

No type of country has been free from costly banking crises in the last quarter century. The prevalence of banking system failure has been at least as great in developing and transition countries as in the industrial world (Honohon and Daniela, 2000). The development of new technologies, major industry consolidation, globalization, and deregulation have placed the banking industry at a strategic crossroads. Therefore, banks face a more competitive, volatile global environment than other types of corporations. They provide financing for commercial enterprises, basic financial services for a broad segment of the population and access to the payment systems. In addition, some banks are expected to make credit and liquidity available in difficult market conditions.

The banking sector, in general, is highly sensitized to public scrutiny and is more vulnerable to the risk of attracting adverse publicity through failings in governance and stakeholder relationships. It is a special sub-set of corporate governance with much of its management obligations enshrined in law or regulatory codes. In the light of the above statement governance issues in banks, more particularly in PSBs, assume immense significance, but unfortunately these are less discussed and deliberated upon. Although the primary reason identified for it is the prevalence of government ownership across the institutions, another important reason can be attributed to the multiplicity of regulatory and supervisory legislations. For instance, in India there are 5 legislations, e.g. RBI Act, SBI Act, Bank Nationalization Act, Banking Regulation Act and Companies Act, which govern the banking sector. Because of this multiplicity of Acts and their enforcing agencies, i.e. RBI and GoI, any concrete form of principles on bank governance is yet to emerge.

From the banking industry perspective, corporate governance involves the manner in which the business and affairs of individual institutions are governed by their boards of directors and senior management, affecting how banks: i) set corporate objectives (including generating economic returns to owners); ii) run the day-to-day operations of the business; iii) consider the interests of recognized stakeholders; iv) align corporate activities and behaviours 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, 1999). All these broad issues relating to governance apply to other companies also, but they assume more significance for banks because they deal with public deposits directly.

Why do banks pose a special governance problem that is different from that faced in ordinary corporations? First, banks' activities are less transparent and thus more difficult for shareholders and creditors to monitor. They become more opaque when

the largest chunk of share capital is with the government. Second, because governments heavily regulate banks, ownership may be dispersed by mandate and thus takeovers may be impeded, directly or through prohibitions on bank ownership. Third, the protection of bank deposits by the government can undercut incentives for depositors to monitor management, thus shifting responsibility for the governance of banks to other parties or institutions. Fourthly, banks also differ from most other companies in terms of the complexity and range of their business risks, and the consequences if these risks are poorly managed.

These distinctions are found in most of the developing countries, but particularly they are quite prominent where there is a dominance of the public sector in the banking industry, as in India. This dominance ultimately breeds weak corporate governance arrangements in the banking systems (Mortlock, 2002), which include: i) inadequately qualified and experienced bank directors, and directors with significant conflicts of interest; ii) insufficient understanding of the nature of banking risks by a bank's directors and senior management; iii) inadequate representation of non-executive and independent directors on the board (i.e. directors unconnected to parties related to the bank); iv) inadequate risk management systems, internal controls and internal audit arrangements; v) insufficient structures for ensuring appropriate scrutiny and management of conflicts of interest, including those arising in business dealings between banks and related parties; vi) insufficient accountability of directors for the stewardship of their bank; vii) inadequate oversight of senior managers by boards of directors, and poor quality financial and risk-related reporting to the board; and viii) insufficient rights for shareholders, including in respect of access to information and the ability to hold the board of directors to account. All these weaknesses can be traced distinctly to the functioning of PSBs in India.

Inadequate corporate governance in banks is rarely attributable to any one factor; it generally results from a combination of factors. One of the more common underlying causes of poor corporate governance is insufficiently developed corporate governance law, including inadequate specification of directors' duties, insufficient clarity of the rights of shareholders and other stakeholders, and insufficient specification of the obligations for dealing with conflicts of interest. In addition, inadequate enforcement of corporate governance law possibly as a result of poorly resourced judiciary and government authorities also impedes the effectiveness of corporate governance. Although inadequacies in the legal framework are often significant factors in weakening the effectiveness of corporate governance in banks, a number of other considerations can also play an important role. These include inadequate development and promotion of a corporate governance culture by the relevant professional associations (such as banking associations). At a more basic level, weaknesses in corporate governance in some countries can be attributable to a culture that attaches relatively little importance to the role of corporate law or to the observance of governance principles. Excessively intrusive financial sector regulation (as prevailed in the pre-liberalization phase of India) and supervision also have the potential to weaken the incentives for effective corporate governance, by weakening market disciplines on banks and by diluting

the responsibility of bank boards for overseeing the management of risks within banks. Similarly, poorly developed financial disclosure arrangements tend to weaken the incentives for the directors and senior management of banks to maintain sound corporate governance and risk management practices.

The reality that various corporate governance structures for banks exist in different countries reflects that there are no universally correct answers to structural issues and that laws need not be consistent from country to country. Acknowledging this, sound governance can be practiced regardless of the form used by a banking organization. Recognizing the diversity in the structure of governance mechanism across the countries the Basel Committee (1999) recommended four important forms of oversight that should be included in the organizational structure of any bank in order to ensure appropriate checks and balances : (i) oversight by the board of directors or the supervisory board; (ii) oversight by individuals not involved in the day-to-day running of the various business areas; (iii) direct line supervision of different business areas; and (iv) independent risk management and audit functions. In addition, the committee also emphasizes the importance of key personnel being fit and proper for their jobs.

Governance in banks is a considerably more complex issue than in other sectors. PSBs attempt to comply with the same codes of board governance as other companies, but, in addition, factors like risk management, capital adequacy and funding, internal control and compliance all have an impact on their matrix of governance. It has been observed that 63 percent of PSBs have potentials for profitability increase through efficiency improvement (Kumar & Verma, 2003), which ultimately depends on the quality of governance. Being under government control PSBs are handicapped in many respects. Some important troubled areas are hindering the best governance practices in these banks. These grey areas are identified and elaborated in the following paragraphs.

Section 2

Areas of Concern

Ownership

PSBs are state-controlled banks and their boards are dominated by representatives from the various sections of society. The need of the board being the guardian of the shareholder's welfare has not found favour in these banks, obviously because of the largest shareholding by the GoI. Since these banks command the largest volume of business in terms of deposits and credits, the composition of their boards is of critical importance. Particularly, the presence of outside professional directors, i.e. of those from outside RBI and GoI, is crucial for their effective governance. The experience of PSBs shows that the dominance of representative type of directors in most of the PSBs has proved to be counterproductive. The fact to add here is that GoI over the years has provided more than Rs. 20000 crores for the recapitalization programme in nationalized banks, which clearly vindicates their shaky performance. The experience of bank recapitalization in several parts of the world has demonstrated that the exercise of recapitalization does not necessarily prevent banks from getting into trouble again. In fact, it often serves to distort the incentive

structure, erode discipline and reaffirm the faith of these institutions in the "deep pockets" of the government (RBI 2001b).

The state control of PSBs has thus belied the expectation of the nation as well as landed the financial sector in more trouble. It is aptly said that on average, greater state ownership of banks tends to be associated with a more poorly operating financial system (Barth, Capiro and Levine, 2000). The World Bank (2002) also raised similar concerns for state ownership and political interference. In its report it observed that i) recent evidence indicates that greater state ownership of banks tends to be associated with lower bank efficiency, less saving and borrowing, lower productivity and slower growth ; that ii) there is no evidence that state ownership lowers the probability of banking crisis; that iii) the evidence is clear that state bankers face political conflicts that generally result in poor performance; and that iv) independence from political decision making can improve governance in the banking sector. Privatization is the only way to ensure this effectively.

Government ownership of a bank has the potential to alter the strategies and objectives of the bank as well as the internal structure of governance. This also thwarts competitive forces, limits the effectiveness of government supervision in the financial sector, and tends to increase the opacity of banks' operations. The government uses state-owned institutions to support excessive spending and to favour less-than-creditworthy borrowers. All these tendencies dampen overall economic growth. In addition, the government often operates institutions, or the regulatory processes that govern them, in ways that discourage the development of vibrant private sector competitors. Consequently, the general principles of sound corporate governance are also beneficial to government-owned banks. Even if the Govt. is interested to dilute its stake to 33 percent it will not help to bring proper governance into practice. This is obvious from the fact that despite dilution the banks are not going to shade their public sector character. The Govt. is still planning to appoint 9 directors out of a total of 15, including 4 whole-time directors. This is just the continuance of current practice in a different way. The restriction on voting rights simply negates the basic principle of equal rights to all the shareholders. Presently, it is also not required to get the approval of the private shareholders of PSBs for paying dividend or adopting annual accounts. That simply overlooks the importance of the shareholder's right.

Composition of the board

The dual charge of Managing Director and Chairman with one person is another cause of worry in most of the PSBs. On the one hand, this helps in removing the rivalry between the two positions and, on the other, it reduces the board's ability to fulfil its proper governance function as an independent body (Dayton, 1984). A proper trade-off between the duality and non-duality of the highest post is thus crucial for institutions like banks, more particularly in PSBs, where the senior directors are nominated by the Govt. Who is the real boss can be a matter of confusion. The board's leadership structure can be conceptualized as a double-edged sword that forces it to choose between the contradictory objectives of unity of command and effective monitoring (Finkelstein and D'Aveni, 1994). Definitely the dual structure comes with cost; it carries the potentialities of rivalry and conflict

between two posts. The non-dual structure, which is not conducive to effective governance, is even more detrimental. Concern was also raised by the Ganguly Committee (RBI, 2002) in this regard. Unless one is mistaken, in the public sector banks/institutions, what is being envisaged is that the Chairman and the MD would both be full-time executives. There is bound to emerge a bi-polar configuration with blood-letting internecine feuds (Tarrapore, 2002). Another issue arises with the composition of executive and non-executive directors on the board and their autonomy. The subsidiaries of the SBI enjoy very limited board autonomy as they have to get clearance on most of the important matters from the parent even before putting them up to their boards. Further, as things stand today, there is no equality among the various board members of the PSBs. The nominees of the RBI and the government are treated to be superior to other directors (Reddy, 2001). There has not been any significant improvement in the autonomy of the board of directors till today.

Governance through committees

The experience of Indian banking, so far as institutionalizing the different committees is concerned, is not encouraging. The status of banks in both public and private sectors reveals a gloomy picture. The leaders in the respective sectors, i.e. SBI and ICICI Bank, have established few committees, but are still short of the international standards. Other banks in the public sector are yet to establish many of them.

The core of governance rests on the quality of transparency and disclosure. The audit committee, being the crucial among all, provides adequate stuff for achieving this most important objective. An audit committtee provides overseeing the bank's internal and external auditors, approving their appointment and dismissal, reviewing and approving the audit scope and frequency, receiving their reports and ensuring that the management is taking appropriate corrective actions in a timely manner to address control weakness, non-compliance with the policies, laws and regulations and other problems identified by the auditors. The independence of this committee can be enhanced when it is comprised of external board members that have banking or financial expertise. This committee needs independent, qualified leadership and membership, which are lacking in PSBs. A key determinant of the effectiveness of an audit committee is the independence, competence, dedication and leadership skills of the audit committee chair (Blue Ribbon Commission). Financial literacy among its members and their independence of the owner are very crucial to its effective functioning. Since in all the PSBs the members of this committee are drawn from the pool of representative directors, there is always a question mark hanging over their effectiveness.

Table 1: Committees set up by Indian commercial banks

Committees set up by banks	*SBI*	*ICICI Bank*	*UBI*
ALM	Y	Y	Y
Audit	Y	Y	Y
Compensation/Remuneration	N	Y	N
Risk Management	N	Y	N
Investor's Grievances	Y	Y	N
Credit	N	Y	N
Business Strategy	N	Y	N
Nomination	N	N	N

Y – Yes N – No

Source: Latest Annual Reports

Risk management, being the backbone of any financial institution, is also very crucial to banks. They face a gamut of risks which are complicated in nature and require specialized hands to handle. These include credit risk, exposure concentration risk, connected exposure risk, interest rate risk, exchange rate risk, equity risk, legal risk, operational risk, liquidity risk, reputation risk, payment system interface risk and business continuity risk. Only a well-manned risk management committee can identify these risks and manage them properly. As per the latest annual reports, most of the PSBs have not yet established any risk management committee, which exposes them to the risk of taking faulty decisions in many operational areas resulting in serious trouble.

Most of the PSBs have established the first two committees, as listed in Table 1. But merely forming these two does not come handy when many of them have already raised capital from the capital market. Besides, business-related committees, investor protection committee and nomination committee are of vital importance.

Supervision

Banking supervision cannot function well if sound corporate governance is not in place and, consequently, banking supervisors have a strong interest in ensuring that there is effective corporate governance at every banking organization. Supervisory experience underscores the necessity of having the appropriate levels of accountability and checks and balances within each bank. Put plainly, sound corporate governance makes the work of supervisors infinitely easier. It can contribute to a collaborative working relationship between bank management and bank supervisors. Putting in place adequate disclosure practices and ensuring their implementation by all the banks are the tasks of the RBI. Standardized codes of international practices and disclosure norms are yet to be evolved on a consensus basis, which has been another serious impediment to the governance of banking sector in India.

Section 3

General Prescriptions for Banks

The Basel Committee has issued several papers on specific topics, where the importance of corporate governance is emphasized. These include "Framework for Internal Control Systems in Banking Organizations" (September 1998), "Enhancing Bank Transparency" (September 1998), and *Principles for the Management of Credit Risk* (issued as a consultative document in July 1999). All these papers highlight the need for proper governance in banking institutions and suggest the following practices to avoid governance problems in banking organizations.

- Establishing strategic objectives and setting up corporate values and communicating them across the banking organization
- Setting up and enforcing a clear line of authority and responsibility
- Ensuring that the board members are well qualified and not subject to pressure
- Ensuring that the board has a clear understanding of their role in corporate governance
- Establishing committees in the bank
- Ensuring that there is appropriate overseeing by the senior management
- Effectively utilizing the work done by internal and external auditors, in recognition of the important control function they provide
- Ensuring that the compensation approaches are consistent with the bank's ethical values, objectives, strategy and control environment
- Conducting corporate governance in a transparent manner

Although the banking industry is more or less similar to other highly profit–oriented corporate entities, the structural and operational complexion makes them different in many respects. Most of the governance prescriptions all over the world basically target the corporate world but many of them are equally applicable to the banking sector.

Prescriptions for directors in banks

More specifically on the role and functions of the directors, the OECD, the World Bank, and the Basel Committee have developed a list of principles which are relevant to corporate governance in companies including banking organizations (Mortlock, 2002). Some of the following can be applied to the Indian banks as well.

- The directors should have the skills and experience necessary to perform their role effectively, and should have a sound understanding of the nature of the company's business and its risks.
- The directors should not accept a position on the board if they have conflicts of interest that would significantly compromise their ability to perform their duties.
- The directors need to satisfy themselves that the senior management team has the necessary skills and experience to perform their functions effectively, in the best interest of the company, and should ensure that there are structures in place for monitoring the performance of the management.
- There should be a clear specification of rights for company shareholders,

including rights relating to access to information, participation in general meetings, and the election of directors.

- There should be a clear specification of the powers, duties and obligations of directors, including the need for directors to act in good faith, with due diligence and skill, and in the best interest of the company.
- Directors should be obliged to satisfy themselves of the adequacy of their company's systems for identifying, monitoring and managing risks and that those systems are being applied effectively at all times. Effective internal audit arrangements, overseen by an audit committee of the board, should be maintained.
- The board should receive all the information they need in order to satisfy themselves that the company's affairs are being conducted in a manner consistent with the business objectives of the company and that all risks are being effectively managed.
- There should be structures to require a strong degree of accountability of the directors to the shareholders and other stakeholders of the company, and of the management to the directors. This includes the need for arrangements to facilitate effective communication with all categories of stakeholders, taking into account the information needs and rights of the stakeholders.
- The board should set key performance indicators for the chief executive and the senior management team and establish a system for effectively monitoring performance.
- The board of directors should be subject to transparent rules governing conflicts of interest and related party lending, and the board decisions in these areas should be disclosed.
- Directors in banks, like those in any other corporate entity, have to understand the contribution by the new technology, new products, new markets, the changing customer behavior, competitors' reaction, international metamorphosis and threat of takeover etc. They need a scorecard to balance financial and strategic issues and to focus on future prospects as well as past performances. Their role goes well beyond the financial responsibility of corporate governance. They have to think how to improve overall performance as well as how to add value to all the stakeholders of the banks including society.

Prescriptions for PSBs

Although many international organizations have made several recommendations to ensure effective governance in banking organizations, those are to be supplemented with some more prescriptions which are context-specific, i.e., to PSBs in India.

- The tardy process of disinvestment across the public sector undertakings including banking is one of the handicaps in this direction. Further, the cap on the right to vote at 10 percent is another stumbling block to attracting both the Indian corporate sector and foreign investors into the banking business. While the current emphasis is on reducing the Govt. stake to 33 percent in PSBs and

hiking the FDI in private sector banks to 49 percent (also necessary for PSBs), the need of the hour is to phase out the voting right cap and noninterference of the Govt. in board matters. But the governance structures need to be improved before widespread privatizations take place in order to prevent small groups benefiting from interconnected lending. For ensuring good corporate governance, the importance of overseeing the various aspects of corporate functioning needs to be properly understood, appreciated and implemented.

- As shown by many private sector banks, the separation of two top key posts has greater capability to face the challenges of the market. PSBs should think of a nomination committee in line with Basel recommendations which will provide an important assessment of board effectiveness and direct the process of renewing and replacing the board members.
- A performance-related compensation package is still a distant dream in PSBs. Although followed in some of the private sector organizations, there is an urgent need to address this issue. The pay packets in PSBs are far less than their counterparts in private and foreign banks. Governance is correlated to the quality of leadership, which in turn depends on the experience and attributes of directors. The latter can only be attracted by an adequate market-related incentive structure. Thus independence in deciding the pay structure in an individual PSB to tap the talent from the market is of crucial significance. Further, there is also a need for linking the remuneration structure to the most important business of banks, i.e., credit management. Officers should be held responsible for the non-performing assets which are caused by their negligence. The statutory prohibition, under section 20 of the Banking Regulation Act, 1949 on lending to companies in which the director is interested, severely constricts the availability of quality professional directors on the boards of banks. This would require a change in the existing legal framework.
- A need is also felt for a well-developed and tested risk management system and adequate exposure of the committee members to risk management, so that they have a well-developed understanding and detailed technical knowledge of the risks and means by which they can be managed. Risk management is more important because of the nature of relations banks maintain with the depositors, creditors and shareholders. The survival of a bank is dependent on maintaining depositor and other counterparty confidence. Making a choice between higher and lower risk lending strategies and between maximizing short-term profit results and longer-term stability, and deciding the appropriate level of capitalization of the bank of connected exposures (to the parent company, other shareholders, and associated parties) and of distributions to shareholders are some of the areas where conflict may arise. The task of protecting the interests of all the groups thus necessitates good corporate governance and risk management arrangements. This can be taken care of by the inclusion of some non-executive and independent professional directors on the board. In the present context of PSBs it can be well addressed by organizing a proper training programme at corporate level for the representative directors.
- There is a need for more public reporting on PSBs, financial condition, more

market discipline and perhaps enhanced fiduciary obligations imposed on bank managers and directors. This is especially needed in emerging market countries like India, where information is scarce and less reliable than in industrial countries, where the economy is dominated by a few family-owned conglomerates, and where state ownership of financial institutions is more pronounced. Disclosure requirements need to be relatively specific, requiring regular public disclosure of a bank's financial performance, capital position, off-balance sheet positions, asset quality, risk exposures and risk management systems. Directors should be held responsible for the veracity of disclosures.

- The RBI should be the single supervisory authority for the entire banking industry and should divest its stake as well as the practice of nominating directors in PSBs. It should supplement some of the audit and regulatory requirements for PSBs. More frequent external auditing of a bank's financial performance and external auditing of its risk management system can be specifically made mandatory. "Considering the growing diversities and complexities of banking business, the emergence of a spate of product innovations with complex risk phenomena, the contagion effects that a crisis can spread and the consequential pressures on supervisory resources, the risk-based supervision approach, which is based on the 'New Basel Accord', is felt to be more appropriate" (Kumar, 2003)

Epilogue

The significant transformation of the banking industry in India is clearly evident from the changes that have occurred in the financial markets, institutions and products. While deregulation has opened up new vistas for banks to augment revenues, it has entailed greater competition and consequently greater risks. Cross-border flows and the entry of new products have significantly influenced the domestic banking sector, forcing banks to adjust the product mix, as also to effect rapid changes in their processes and operations in order to remain competitive in the globalized environment. These developments have facilitated greater choices for consumers who have become more discerning and demanding compelling banks to offer a broader range of products through diverse distribution channels. The traditional face of banks as mere financial intermediaries has since altered and risk management has emerged as their defining attribute. Today's corporate governance means to do everything better and provides for risk assessment, risk cover, early warning systems against failure as well as prompt corrective action.

Managing the transformed environment needs effective governance. Although the market forces in India are not strong enough to discipline the managers/executives, in recent years there has been a growing pressure from inside as well as outside to adhere to the international practices of governance. One of the more common underlying causes of poor corporate governance is insufficiently developed corporate governance law, including inadequate specification of directors' duties, insufficient clarity about the rights of shareholders and other stakeholders, and insufficient specification of the obligations for dealing with conflicts of interest. In addition, inadequate enforcement of the corporate governance law, possibly as a result of poorly resourced judiciary and government authorities, also impeds the effectiveness of corporate governance in the financial sector as a whole and banking

in particular. The gradual disinvestment in PSBs with adequate autonomy and the participation of foreign investors in their capital structure will be the effective ways to establish a broad-based governance structure. When PSBs enter the capital market with their new issues, they have to ensure that their governance mechanism is efficient enough to deliver the best on a par with the rest of the corporate world.

Most of the governance codes/principles talk about the committees, the board and its independence etc., but then nothing can happen unless these principles percolate down to the middle-level managers and operating staff. In the banking organization it is of utmost necessity that the personnel at different desks and counters recognize the importance of proper governance and follow the ground rules with sincerity. There is an urgent need to establish a culture of governance across the PSBs to ensure their societal acceptance as responsible corporate citizens.

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