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DO BOARD CHARACTERISTICS AFFECT PROFITABILITY? EVIDENCE FROM PUBLIC SECTOR BANKS IN INDIA

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ABSTRACT--*The focus of this paper is to analyze the relationship between board structure and performance of 21 public sector banks (PSUs) in India. We have used the panel data analysis to study the relationship between the board characteristics and profitability of public sector banks. The time period of the study is from the year 2013-2018, covering the most recent period of time after amendments in the Companies Act, 2013 regarding the structure of the board. The board structure is one of the most important factors of corporate governance mechanism that plays a major role in the decision making of the firm. Therefore, the present study tries to find out the impact of board structure including major variables such as total board size, number of independent directors in the board and women directors, on the profitability of public sector banks. The study has used secondary data from the annual reports of concerned bank. It is an analytical paper which uses accounting approach to measure Return on Asset (ROA) and Return on Equity (ROE) as major performance indicators. The result finds a significant impact of board size on the performance of banks while there is no significant impact of number of independent directors and women directors on the performance of the public sector banks.*

Keywords--*Bank Performance, Board structure, Corporate Governance, Public Sector banks.JEL classification: G21, G34*

I. INTRODUCTION

Corporate Governance practices help to protect and strengthen the positions of all stakeholders (shareholders, employees, supervisors, customers, the public, etc.) as well as the whole economy. Many researchers have studied the concepts of governance and presented the unique definition of the aforementioned. The Organization for Economic Co-operation and Development (OECD) 2004, defined corporate governance as a "set of relationship between a company's management, its board, its shareholders and other stakeholders, and provides a structure through which goals are set and monitored". Ireland et al., 2011 state corporate governance as a mechanism for the purpose of maintaining, controlling and managing the stakeholder's relationship and strategic decision of the organization. World Bank, 2009 also defined corporate governance as the process and structure for the direction of an organization concerned with the relationship between stakeholders, management, the board of directors and other stakeholders. Generally, misalignment and conflict of interest among stakeholders leads to agency problems

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in the organizations, where managers may maximize their interest at the expense of other stakeholders (Jensen and Meckling 1976; Shleifer and Vishny, 1986). Corporate governance is the mechanism, which is used to resolve these problems. It enhances efficiency, increases the investor's confidence and strengthens the growth of any firm (OECD 2004). "Good governance is needed in every sphere of life." Governance, in general terms, means the process of decision-making and the process by which decisions are implemented (or not implemented), involving multiple actors. Good governance is one that is accountable, transparent, responsive, equitable and inclusive, effective and efficient, participatory, consensus-oriented and follows the rule of law

While corporate governance is the basic mechanism adopted worldwide to improve the performance of any firm, there is a different opinion on corporate governance regarding its structure, increasing importance and implementation in firms. Due to the variations in opinions, it attracts the attention of various researchers, countries, and companies from time to time. Corporate governance is increasingly getting attention as one of the mechanisms, which affects the profitability of any firm, whether it is financial or non-financial. In this context, the corporate governance for the banking sector has started gaining attention[4]. It is very well known that banks play an important role in the development of any country's economy, its governance becomes utmost important and requires intense regulation. The regulation also challenges the governance of banks (Levine, 2004). Bank governance includes a wider aspect of stakeholders in the form of customers and creditors, which enhances its importance and its concern in financial sectors (Damak, 2013). For smooth functioning and to prevent failures in any organization proper installation of corporate governance structure is required. Hence, various regulatory and government authorities, from time to time make sincere efforts to revise the regulations according to the present conditions of the economy.

(Halder & Rao, 2012) developed a corporate governance index for listed Indian companies using major corporate governance variables, namely the board of directors, audit and board committees and disclosure practices. This index helps them in analyzing the advancement of corporate governance practices in India. They examined the relationship between Corporate Governance Index and companies' financial performance and confirm that the companies who actively respond to the reforms of corporate governance get more values in the Indian market and thus encourages the regulators to do further reforms for enhancing the performance of companies. However, with the failures, scams, swindles, and frauds that is increasing day by day in the corporate world, it would raise a question mark on the implementation of such regulations.

After the crisis in 2008, the role of directors in the corporate governance of financial institutions also got attention among policymakers and researchers (Sarkar & Sarkar, 2018). Following it, Basel in 2010 highlighted the importance of the board of directors, their qualifications, executive compensation and understanding of the bank's operational structure by issuing a set of principles in order to improve their corporate governance mechanism. Walker, 2009 and OECD, 2010 also initiated some important efforts at international level to improve governance in banks by board of directors.(Sarkar & Sarkar, 2018) found that the impact of corporate governance on the performance of private sector banks couldn't be applied in same manner on state-owned banks in regard to the effects of board independence, CEO duality and tenure on ownership groups. (Belkhir, 2009) used the sample of 174 bank holding companies and savings-and-loan holding companies and revealed that in a banking organization less attention has been given to board governance and effectiveness, maybe as the regulations put up

[4] Corporate Governance Mechanisms Adopted by UAE National Commercial Banks,(2015)

limit the role of directors on the board. But nowadays, with the changing business environment and increasing competition in the market, the role of board governance becomes more relevant to protect the interests of various stakeholders. Noting the fact that state-owned banks have high opaqueness and heavy regulations. Many of other studies demonstrated imperative evidence on the board governance by analyzing the effect of various attributes of board like total board size, CEO duality, gender diversity, busyness of directors, their qualifications, etc. on the performance of banks (Adams and Mehran, 2012; Andres and Vallelado, 2008). These studies had also focused on the board structure with its main aspects like total board size, independent director's size, and numbers of women directors on the board. The study investigated the impact of board characteristics on the profitability of Indian public sector banks during the time-period of 2013-2018. For investigating the mentioned issue the study has used secondary data from the annual reports of concerned banks. It is an analytical paper using the accounting approach to measures Return on assets (ROA) and Return on Equity (ROE) as the major performance indicators. The result found that there is a significant impact of board size on the performance of public sector banks while there is no significant impact of number of independent directors and women directors on the performance of the public sector banks.

The remainder of this paper is structured as follows. The second section includes a review of the literature on board structure and profitability and hypothesis formulation. The third section includes data selection and methodology with model specifications. The fourth section comprises hypothesis testing, results, and discussions. Finally, the Fifth section summarizes the findings of the research and conclusion.

II. REVIEW OF LITERATURE

De-regulation leads to transformation in the banking industry and this had given rise to new challenges and competition for the banks. Corporate governance is providing better risk assessment and works as a prompt corrective measure against failures and so can be treated as a mechanism to do everything better (Deb, 2013). (John & Senbet, 1998) focus on the role of corporate governance in solving agency problems like a conflict of interests among stakeholders. Implementation of corporate governance practices can ensure that the banks cope up with the changing environment and be retained in the global economy.

For financial sectors also, like the non-financial sector, corporate governance is important in various ways. Like, first, in developing countries usually, the government takes initiatives to support the developing financial system. Thus arises the most common agency conflict between government and managers controlling the banks. Secondly, in such economies wider aspects of corporate governance leads to strong information disclosure and legal protection. (Arun and Turner, 2002).Further, it will prevent the scope of managers to take more risk on investment where the cost is borne by depositors and high gain harvested by the owner (Diamond 1983, Arun & Turner,2002). (Ramesh, 2019 & Siddiqui & Koche, 2018) examine the determinants of bank performance by considering ROA & ROE as performance indicators and concluded that Non-performing assets negatively influence banking performance. According to (Sahu, Maharana, & Chaudhury, 2017) corporate governance has improved during past years but has not resulted in lowering down the number of NPAs in both the public and private sector banks. The researcher suggests that not only corporate governance but also other various factors are responsible for NPA, so, for better financial performance, a healthy loan portfolio has to be developed. (Andrieș, Căpraru, & Nistor, 2018) suggested that higher costs for banks and low levels of efficiency are associated with rigorous corporate governance structure. According to (Andres and Vallelado, 2008) complexity in banking operation results in a higher order of information asymmetry rather than non-financial sectors. For any developing country, like India, commercial banks play an important role in the progress and stabilization of the various sectors and also to maintain its growth in tough times (Mayur & Saravanan, 2017).

The Basel Committee on Banking Supervision (BCBS) also emphasized that sound corporate governance or bank's board of directors and senior management should contribute to the performance of banks, as they are primarily accountable and responsible for the performance of banks. So, it becomes more important to analyze the significance of the board and its attributes in enhancing the bank's efficiency (Titova, 2016). As empirical literature suggests, various parameters of corporate governance affect the profitability of banks. Various parameters of corporate governance include board size and composition, CEO duality, CEO tenure, CEO composition, gender diversity, etc (Adams & Mehran, 2012). (Abhiman Das and Saibal Ghosh) explore the link between CEO turnover and performance and suggested that CEO turnover has a bearing on bank performance.

III. BOARD SIZE AND PERFORMANCE

New evidence has revealed that board independence is not related to performance but an increase in board size with the increase in directors may add value to the firm (AlQudah, A.M. et al., 2019). While (Ali, 2018) finds that organization size is positively related to board size and board size is associated with performance in manufacturing organizations. Further, the study suggests that this relationship is conditional and has an indirect effect on the performance of the industries. (James & Joseph, 2015) suggested, with the help of resource-based theory, that there may be duplication of resources due to a large number of outside directors, which appear to be less advisable and beneficial for the bank's better performance. Board size along with board structure is a requisite element for corporate governance and its quality (Mayur & Saravanan, 2017). (Raheja 2015) questioned the ideal size and composition of the board. He also models the interaction of outsiders and insiders on a corporate board and develops a testable implication for the variations in optimal board structure among firms. He showed that the firm’s characteristics and directors affect the optimal size of the board. (Malik, Wan, Ahmad, Naseem, & Rehman, 2014) also examined the relationship between board size and performance with Pareto approach for Pakistani banking sector. He finds contradictory results against existing literature and concluded that bank performance can enhance by large board size in Pakistan’s scenario. While (Belkhir, 2009) finds little evidence that the present board size affected directly by past performance but resultant to this it also suggests that a reduction in a number of directors might adversely affect the performance.

H1: Board size impacts the performance of public sector banks.

IV. INDEPENDENT BOARD SIZE AND PERFORMANCE

(Titova, 2016) argued that board with a higher proportion of independence or outside directors provided with more opportunities to better control and monitor the management for aligning stakeholder's interests. (AlQudah, A.M. et al., 2019) by considering the sample of 14 Jordan banks from 2013-2017 concluded that the number of independent directors should be increased in order to get better financial performance of banks. (Abdul Gafoor, Mariappan, & Thyagarajan, 2018) by using a sample of 36 scheduled commercial banks in India with taking the time period of 2001-2014 explored the impact of board independence on bank performance and suggested that there is a need to reorganize the board size and composition of independent directors on the board. (Tulung & Ramdani, 2018) conclude that the independent decisions suggested by the independent director lead to the enhancement of good corporate governance.

H2: Number of Independent directors on board impact the performance of public sector banks.

V. WOMEN DIRECTORS AND PERFORMANCE

(Lakhal, 2015) suggests that women directors on board are an important part of corporate governance and play an effective monitoring role in the board. (Arena, 2015) studying the relationship between women directors and firm performance in a sample of 211 masculine industries (manufacturing industries) concludes that the presence of women might impact dynamics within the boardroom. It also shows shreds of evidence of increasing benefits on performance by "critical mass" rather than presence of women on the boards. While (Terjesen, 2016) empirically finds that firms with more women directors on their board have high performance by market and accounting measures. As well as they also suggest that, the board with gender diversity contributes to the performance of any firm with the external independent directors. (Poletti, 2019) finds the evidence from the data of Latin America that the differences in the appointment of women directors as non-independent or independent directors and whether the firm is family-controlled or not affects the motivation for risk-taking in the firm. They also find the inclusion of female directors on the board very important from the perspective of business and socio-emotional wealth (SEW).

H3: Number of women directors on board impact the performance of public sector banks.

By reviewing the prior literature, the authors presented the pictorial model of factors influencing bank performance and how it is measured in the present study.

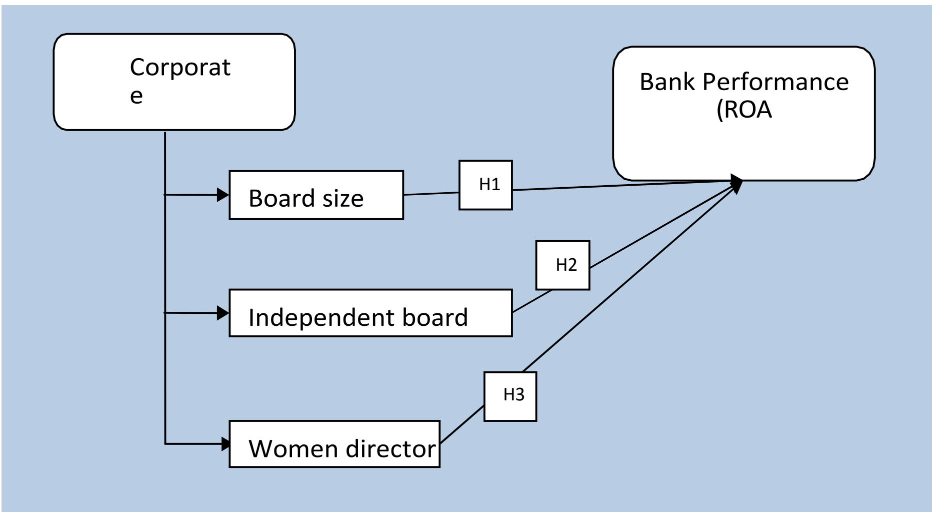

Figure 1: Author's presentation

VI. DATAANDMETHODOLOGY

Sample Selection

To construct a panel data, data of all Indian scheduled 21 public sector banks were collected. The total sample comprises 18 public sector banks out of 21, as 3 banks among them have been merged during the time of data collection, for a period of 5 years ranging from 2013- 2018. Financial information is mainly collected from the CMIE database and annual reports of all the banks. The corporate governance as independent variables used in this study is board size (total no. of directors), independent board (number of independent directors) and women director (number of women directors on board) while performance variables as dependent variables include return on asset (ROA) and (ROE). Two control variables- total asset and leverage ratio are used to control a firm's assets and leverage.

The data is cross verified with the records accessible in the annual financial statements to verify accuracy.

Description of variables

The variables used for the study are classified into three broad categories: performance variable, governance variable, and control variable. Performance variables are used as a proxy for dependent variables, and governance variables as a proxy for independent variables. The control variables are used to control the potential effects of other variables on banks' performance.

Table 1: Description of variables

Nature of variables	Measurement of variables	Description of variable
1. Dependent variables (Bank Performance)	ROA	Net income over total assets/ Net income divided by total assets/ PBIT to total assets (%)
	ROE	Net income over shareholders' Equity
2. Independent variables (Corporate governance)	Board size	The total number of directors present on the board.
	Independent board	Number of Independent directors over total board size.
	Women directors	The number of women directors on board.
3. Control variables	Assets	Firm's total asset value

Leverage	Debt-to-equity ratio

Sources of variables

The identified variables for the study are mentioned through an extensive review of the literature. Many researchers had used these variables in their study. Table 2 presents the sources of variables taken from the mentioned research paper.

Table 2: Sources of variables

Name of variable	Acronym	**Literature** evidence
Corporate Governance variable		
Board size	BSIZE	Dwivedi and Jain (2005), (Belkhir, 2009)(Ghayad, 2008)(Mayur & Saravanan, 2017)(Abdul Gafoor et al., 2018) **(**AlQudah, A.M et al.,2019) (Tulung, J.E. and Ramdani, D., 2018)
Independent board	IBSIZE	(Belkhir, 2009)(Ghayad, 2008)(Abdul Gafoor et al., 2018) **(**AlQudah, A.M et al.,2019) (Tulung, J.E. & Ramdani, D., 2018) (Mollah, S. et al., 2018) (Nwanne & Okonkwo, 2019)
Women Director	WDSIZE	(Lakhal,2015)(Poletti,2019) (Gulamhussen,2015) (Fan, Y. et al., 2019)
Performance variables		
Return on asset	ROA	(Belkhir, 2009)(Dwivedi & Jain, 2005)(Ghayad, 2008)(Abdul Gafoor et al., 2018)(Mayur & Saravanan, 2017)
Return on Equity	ROE	(Abdul Gafoor et al., 2018)
Control variables		
Total Assets	FSET	(Belkhir, 2009)(Ghayad, 2008)(Abdul Gafoor et al., 2018)
Leverage	FLEV	(Abdul Gafoor et al., 2018)

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Model Specification

To analyze the impact of governance variable on bank performance, this paper used two regression equations. These following equations are representing the model of our study.

$ROA_{it} = \alpha + \beta_1 BSIZE_{it} + \beta_2\ IBSIZE_{it} + \beta_2\ WDSIZE_{it} + \gamma\ \ controlvariables_{,t} + \varepsilon_{i,t}$ (1) $ROE_{it} = \alpha + \beta_1 BSIZE_{it} + \beta_2\ IBSIZE_{it} + \beta_2\ WDSIZE_{it} + \gamma\ \ controlvariables_{,t} + \varepsilon_{i,t}$ (2)

In the above equations, *i* denotes individuals from 1 to 21 and *t* denotes the time frame from 2013-2018. *B* parameter confines the probable impact of board size, independent board and women director on the bank performance. The first equation is used to validate the relationship of ROA as a dependent variable on the independent variables such as board size, the independent board size, and women director. While in the second equation ROE has used as the dependent variable to find the relationship and impact of variables.

The pooled panel data method has been used, as it is the most appropriate method for analyzing the data used in this study. In the present study, the data contains the features of both time series and cross-sectional type of data, so the author considered panel data analysis

VII. RESULT AND DISCUSSION

Table 3: Descriptive statistics for variables (mean, median, standard deviation, min, max)

Variables	Mean	Median	SD	Minimum	Maximum
ROA	-0.18156	0.165	0.764252	-2.54	0.68
ROE	-4.83178	3.06	17.11841	-60.61	15.7
BSIZE	14.70787	15	3.659366	8	32
IBSIZE	2.494382	2	2.81281	0	11
WDSIZE	1.011111	1	0.756907	0	4

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Table 4: Regression result for ROA

	Estimate	Standard Error	t-value	**Pr(>|t|)**
Intercept	-1.3300388	0.3162346	-4.2059	6.412e-05***
BSIZE	0.0895470	0.0222326	4.0277	0.000122***
IBSIZE	0.0069215	0.0272376	0.2541	0.800021
WDSIZE	-0.1802265	0.1073304	-1.6792	0.096791
R-Squared	0. 16622			
Adj. R-Squared	0.13679			
F-statistic	5.64828			
p-value	0.0014085			

Table 5: Regression result for ROE

	Estimate	Standard Error	t-value	**Pr(>|t|)**
(Intercept)	-29.376552	7.118369	-4.1269	8.546e-05 ***
BSIZE	1.982667	0.500452	3.9618	0.0001542 ***
IBSIZE	-0.075698	0.613112	-0.1235	0.9020305
WDSIZE	-4.318457	2.415983	-1.7875	0.0774285
R-Squared	0.15896			
Adj. R-Squared	0.12927			
F-statistic	5.35501			
p-value	0.0019963			

The regression analysis is represented in table 4 and table 5 for the dependent and independent variables. Tables 4 and 5 present the regression result of Pooled OLS. The results revealed the impact of board structure, which includes total board size, the independent board size, and women directors on the performance of banks based on ROA and ROE. Results of Tables 4 & 5 reject the Null Hypothesis 1 that board size does not impact the performance of the bank. These results exhibit that board size has a significant impact on ROA and ROE of public sector banks, which is consistent with previous studies (Dwivedi and Jain, 2005) and (Arora and Sharma, 2016). While the results of table 4 & 5 support the Null Hypotheses II &III that independent board and women director does not impact the performance of bank. It implies that the independent board had no significant impact on performance of the public sector banks, which is consistent with previous studies, i.e. (Dwivedi& Jain, 2005; Arora &Sharma, 2016; Nwanne & Okonkwo, 2019). The same negative impact found for the women director on the board that is shown too by (Meca& Ferrero, 2015).

VIII. CONCLUSION

Our study analyzed the impact of corporate governance practices on the performance of selected public sector banks forms 2013-2018 by using pooled panel data method for regression analysis. The paper indicates a comprehensive study of the board structure and performance of public sector banks. Our study finds that there is not so strong relationship between corporate governance and performance of public sector banks of India. This paper concludes that there is a significant impact of the board size on banks' performance but other board characteristics such as independent board directors and women directors on the board do not significantly impact the performance of banks.

While in the developing economies, the phenomenon for independent directors and women on the board is new and thus it might take more years to improve tremendously and their impact on the performance of banks in India. Initially, may not be followed in the way they should be or there can be some limitations due to rules and regulations. Nevertheless, in future amendment can happen according to the unfavorable bank situation of developing economies, for better utilization and improvement of this phenomenon. While diversity, as suggested by the previous study, significantly impacts the performance with board size, is not supported by our study. Yet, there are many other factors that influence the performance of any firm and not all of them are possible to control in the study. The present study attempts to identify the impact of corporate governance variables on the performance of public sector banks in India, its result may lead to future scope to explore more research in this area with wider and different aspects. The limitation of this study is that it had taken only public sectors of India; future research can be attempted by considering the cross-country corporate governance policies and their impact on the performance of banks.

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