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# An empirical analysis of Factors of Mechanism of Corporate Governance and Bank-Specific Factors affecting the performance of selected Indian Banks

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### ABSTRACT

An organized Banking sector of any country act as a catalyst for the economic development of the country, Indian Banking sector is the most important component of Indian financial system which work on many dimensions for the economic development of the country including mobilization of savings to the Indian financial system through wide network of Branch Banking that leads to availability of funds to investment purposes and capital formation for the developing country like India, where as the performance of Indian banking sector is not up to the mark from more than five years, so the present study aim is to examined the effect of bank's specific ratios and selected parameters of corporate governance mechanism on Earning per Share (EPS) of selected eight Indian banks. Earnings per share (EPS) have taken as dependent variables to know financial performance of eight selected Indian Banks. Whereas gross nonperforming assets (GNPA) and Dividend Payout Ratio (DPR) were taken as bank specific independent variables, On the other hand board independency (BIND), Frequency of board meeting (FBM) and capital adequacy ratio (CAR) were considered as parameters of corporate governance. The present research using Panel multiple regression techniques to analyze the factors affecting the earning per share (EPS) during the period 2010 – 2019, On the basis of Hausman test the null hypothesis - random effect model is appropriate is rejected due to ( $p < 0.05$ ) and alt hypothesis-fixed effect model was accepted and found appropriate for the model applied for the study. The study revealed the following result-- Board independency (BIND) is positively related with the earning per share but statistically insignificant but frequency of bard meetings (FBM) and dividend payout ratio (DPR) are positively related with the EPS as well as statistically significant, capital adequacy ratio (CAR) and gross non-performing assets (GNPA) are negatively related with EPS but CAR is insignificant and GNPA is statistically significant.

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### Introduction

In the modern economic system banking sector plays a very emphatic role in the economic as well as social development of the country, they provide loan to the business and also facilitate import and export trade. Indian banking sector plays an important role in nation building through providing the wide network of financial infrastructure which ensured the financial health of a country. According to Reserve Bank of India, Indian Banking Sector is sufficiently capitalized and well regulated. The diameter of Indian banking sector has reached not only to the big cities but also reached to the backward areas of the country and uplifting rural economy as well. It is also acknowledge that total lending of Indian banking sector has increased 10.94% CAGR in 2007-18 and total deposit is also increased at CAGR of 11.66%. The growth of all the sectors in India is directly or indirectly associated with the Indian Banking sector due to financial assistance and other Banking services including accepting deposits, lending loans, agricultural and rural development etc. Indian Banking sector is witnessed for many changes in the last two years for the upliftment of the economy which includes the launching of Indian post

payment Bank with wide spread branches in 650 districts as on September 2018. India's micro finance sector's equity fund has also shown sharp growth of 96.31 billion from 39.88 in 2017-18.

The present study explores the Importance of corporate governance mechanism and bank specific variables in the performance of selected banks. The study included two variables of corporate governance namely board independency, capital adequacy ratio and frequency of board meeting in the performance of selected Indian banks, while on the other side banks specific ratios focused in the study are dividend payout ratio (DPR), gross non-performing assets (GNPA) and earning per share (EPS) is used for assessing the performance of selected Indian Banks.

### Literature review

#### Board independency (BIND) and Bank performance

Board independency indicates to the composition of independent directors to the board of a company to avoid unnecessary and biased decisions. Alam and Akhtar (2017) studied the relationship between board independency and earnings per share as one of the parameter of banks performance and concluded that there is no significant

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relationship between selected variables. Dzingaai et.al (2017) observed weak but positive correlation between independency in board and return on equity. Buallay et.al (2017) revealed the insignificant relationship between board independency and performance of listed companies of Saudi stock exchange. Over the study of 36 scheduled commercial banks during 2001 – 2014 Mariappan and Thyagarajan (2018) revealed positive and significant relationship between board independency and banks performance. Performance of state owned banks had strong effect of numbers of independent directors in board composition in the research of Jayati Sarkar and subrata Sarkar (2018).

#### **Frequency of board meeting (FBM) and Bank Performance**

A large number of researchers argue that frequency of board meeting may or may not influence the performance of banks, anshuman kumar and yatin nihalani (2014) examine the impact of numbers of board meetings in a year on earning per share (EPS) and the finding concluded that there is no significant relationship between board meetings and EPS. Rekha handa (2014) concluded that there is a negative significant relationship between board meetings and financial performance of banks Narwal and Jindal (2015) has found no significant relationship between board meetings and profitability of banks with the help of correlation and ols regression model. Over the study of 42 Bahrain banks essa ahmad and allam hamdan (2015) concluded that corporate governance variables doesn't significant to the performance of banks. Ahmad Al-baidhani (2014) analyzed the impact of board meetings in a year on the performance of banks through return on assets and found positive and significant relationship on ROA. The performance of banks were studied on the basis of ROA, ROE and EPS through the impact of frequency of board meetings and found positive relationship between independent and dependent variables after applying correlation and regression by najeeb haider et.al (2017). Moderate relationship between ROE & ROA and Board Independency & Frequency of Board Meetings was observed through multiple regressions in the study over 275 firms listed in NSE during (2011-15) by Palaniappan G. (2017). Uzma, and Fatima et.al (2018) revealed that there is insignificant statistical relationship between board meetings and return on assets & earning per share.

#### **Capital adequacy ratio (CAR) and Bank Performance**

Rafiqul alam and fahmida (2017) in their study revealed liner relationship exist between car and return on assets and nonlinear relationship between car and return on equity & earnings per share of commercial banks of Bangladesh. Capital adequacy ratio was found insignificant with the performance of listed banks in Indonesian stock exchange during the period (2008-12) in the study of Lukas and Basuki (2015). Multiple regression analysis over 40 banks for the duration 2008-09 to 2011-12 has shown capital adequacy ratio is positively related to the performance of banks through return on assets and return on equity in the study of kanojiaandpriya (2016).

#### **Gross non-performing assets (GNPA) and Bank Performance**

A study over seven public sector banks was done by Chetan Dhude (2017) to know the relationship of Gross non-performing asset on net profit of banks by applying panel regression and revealed except SBI and PNB banks namely BOI, United Bank of India, BOB, Indian overseas bank and central banks of India had negative correlation between gross

non-performing assets and their net profit where as SBI and PNB has shown positive correlation between their GNPA and net profit. Arasu et.al (2019) has found gross non-performing assets negatively significant with ROA while net NPA was positively significant with ROA in their study covering ten public and ten pvt sector banks. Except SBI all five nationalized banks were negatively correlated in their relationship between gross non-performing assets and net profit whereas in sbbi net profit was not at all affected by GNPA in the study of kiran and jones (2016). High correlation was revealed in the research of Jayakkodi et.al (2016) between gross non-performing assets and return on assets of public and private sector banks. Performance of Indian Scheduled commercial banks for ten years from 2007-08 to 2016-17 and also the impact on non-performing assets on their profitability was analyzed through regression analysis and concluded that there is significant relationship of GNPA with gross advances and ratio of net npa to net advances on the other hand insignificant relationship between gnpa to total assets and net npa to net advances was found in the research of Nachinruthu and Vein (2019).

#### **Dividend Payout Ratio (DPR)**

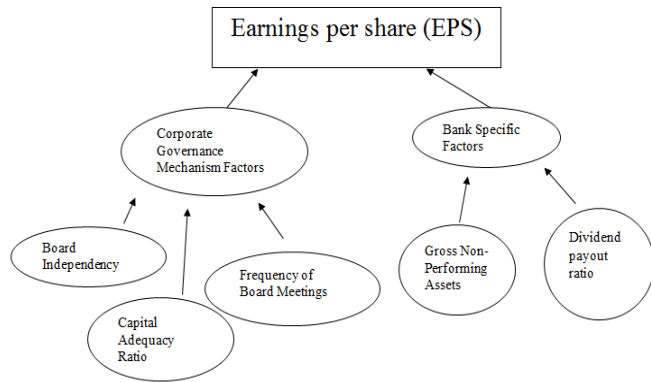
Murekefu and Ouma (2012) investigated the relationship between dividend payout ratio and the performance of listed firms in Nairobi securities exchange during the period (2002-2010) with the help of regression analysis they found strong positive relationship which revealed that's Dividend policy was relevant. Impact of dividend payout ratio on the financial performance of fifteen banks through return on equity on the Nigerian Stock exchange from 2009-2014 was studied by E.Idewele and A.Murad (2017) which revealed positive significant relationship between dividend payout ratio and financial performance of banks. Dividend payout ratio was found negatively related with the performance of deposit money banks in Nigeria by using correlation analysis and multiple regressions in the analysis of Yusuf BR (2004-13). Shareholder wealth was found negatively significant with the dividend payout ratio significant of the five industries in India namely automobile, infrastructure&construction, energy, information technology and pharmaceutical in the research of Thirumagal and Vasantha (2018) covering 2001-2015 by using Panel Data Regression. Dividend policy was studied to know the impact of dividend payout ratio on earning per share of Indian automobile companies specifically tata motors and force motors which revealed dividend payout ratio was positively significant with EPS. Nadeem khan and shamim has researched the impact of dividend payout ratio on earning per share of the companies belongs to eight sectors which were listed in Karachi stock exchange during 2009-2013 which resultant EPS had positive impact on all the eight sectors except forestry sector (paper and board) in which there was negative association between dividend payout ratio and earning per share. Return on equity and financial leverage were negatively significant with dividend payout ratio but earning per share was not clearly significant with dividend payout ratio in the research of Do Thi Van Trang (2016).

#### **Conceptual Framework**

##### **Hypothesis**

1. Board independency has significant impact on EPS.
2. Capital adequacy ratio has significant impact on EPS.
3. Frequency of Board Meetings has significant impact on EPS.
4. Gross Non-Performing Assets has significant impact on EPS.

## 5. Dividend payout ratio has significant impact on EPS.

**Econometric model**

$$EPS_{it} = \alpha + \beta_1 BIN_{it} + \beta_2 CA_{it} + \beta_3 FM_{it} + \beta_4 GNA_{it} + \beta_5 DPR_{it} + \varepsilon_{it}$$

Where  $i$  stand for banks from 1 to 8 and  $t$  represents the duration of time period from 2009- 2019. The  $\beta$  parameter shows the impact of various variables on the performance of banks.

**Variables description****Earnings per Share (EPS)**

As one of the performance indicator of a company earnings per share indicates the profitability of a company which is calculated by dividing the company's net income with its total number of outstanding shares. It is a tool which is used by the investor before purchasing the shares of a business concern, it contribute the portion of a company's profit allocated to every shareholders and it is also termed as the most important criteria for investors and persons who trade in the stock market.

**Board independency (BIN)**

Board independency refers to the independent directors in the board of the company to bring transparency, fairness and unbiased decisions. The requirement of independent directors in the board is applied on the basis of legal requirement as per the clause 49 in which atleast one third of the board should be independent director if the chairman is a nonexecutive director while on the other hands atleast fifty percent of the board should be independent if the chairman is executive director.

**Capital adequacy ratio (CA)**

It is considered as the most important indicator which is also known as minimum statutory requirement of capital that portray long term survival capacity of business, it is a kind of guarantee to the depositors and help banking companies to prevent insolvent. It is considered as the way to the protection of depositors and creditors interest which ultimately absorb losses.

**Frequency of Board Meetings (FM)**

Board meetings refers to the number of board meetings or frequency of board meetings in a year which is also legally required at least four in a year and should not be more than 120 days gap between two meetings as per companies' act 2013, so that board of directors can highlight the issues and challenges and make proper strategies.

**Gross non-performing assets (GNA)**

As per RBI it refers to the aggregation of all non-performing assets which refers to the loss of interest along with loss of principal amount as well during particular period of time. The amount of loan and its interest which is not recovered are term as non-performing assets.

**Dividend payout ratio (DPR)**

The amount paid out to shareholders in the form of dividend in percentage known as dividend payout ratio, it refers to the ratio of the total amount of dividend paid out to shareholders relative to the net income of the company. It indicates how much money a company is returning to shareholders.

**Data and sample**

Present study is based on secondary data which collected from annual reports of banks and number of websites which comprises of ten years from 2009-2019 and sample size of eight Indian banks on the basis of market capitalization.

**Data analysis****Descriptive analysis**

Table 1 presents descriptive statistics of selected variables. Average of BIN is 7 Minimum and maximum Bind is 3 and 12. Average fbm was recorded as 9.26, min 4 and max 20 boards meeting in a year. Average of GNPA is 2.8% during the selected time period with min 0% and max 12.26%. dpr is shown 1.19% as average and -80% min and 1.89% max. During selected time period car has 15.65% in average followed by 11.98% min and 20.50% max. On average 44.29% of eps is recorded with -23.89% min and 210% maximum.

**Table.1**

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
BIND	80	3.00	12.00	7.0000	1.96810
FBM	80	4.00	20.00	9.2625	4.07755
GNPA	80	.00	12.26	2.8893	3.07558
DPR	80	-.80	1.89	1.1988	.58518
CAR	80	11.98	20.50	15.6569	2.10416
EPS	80	-23.89	210.06	44.3947	46.29443
Valid N (listwise)	80				

**Table.2. Regression result for EPS**

EPS	Panel A	Panel B
	Random effect	Fixed effect
Intercept	-9.312705 (0.8561)	-64.07586 (0.2851)
BIND	7.3101118 (0.0019)	4.345759 (0.1667)
FBM	5.768243 (0.0001)	5.226417 (0.0027)
CAR	-5.389442 (0.0317)	-0.863110 (0.7915)
GNPA	- 4.369426 (0.0192)	-3.744928 (0.0581)
DPR	38.46879 (0.0002)	45.02545 (0.0001)
ADJUSTED R <sup>2</sup>	0.391500	0.563095
F-statistic	11.16549 (0.000000)	9.484763 (0.000000)
Hausman test	11.971191 (0.0352)	

The Hausman test was run to test the model specification, the result shows that p-value is 0.03 which is found less than significant level of 5% therefore null hypothesis that random effect model is appropriate is rejected and alternative hypothesis of need to be implying in which fixed effect model was observed the most appropriate model for selected data set, Out of two models, fixed effect model is used for the explanation of the result.

**Regression result**

As per table 2 the empirical results of the study is done on the basis of random effect and fixed effect model, but on the basis of Hausman test fixed effect model is found most appropriate so that the explanation is done on the basis of fixed effect model. The empirical result shows that board independency is insignificant with the performance of the selected banks and there is no relationship is found between presence of independent directors in the board and earnings per share of the selected banks which is inconsistent with the

previous study (Alam and Akhtar 2017) Cornett, McNutt and Tehranian (2009) advocated that board independency is responsible for better and qualitative earning and consistent with the study of (Intezar and Saleem 2018). The result doesn't support the hypothesis that board independency has significant impact on earnings per share which revealed that independent directors are not only responsible variables to monitor the performance of the banks. The regression result shows in table 2 that frequency of board meeting and or number of board meeting in a year is positively significant with EPS of the selected Indian banks which is inconsistent with (Anshuman Kumar and Yatin Nihalani 2008, Bashir et.al 2018) and consistent with ( Haider et.al 2017), It may conclude that board meeting at regular interval of time may noticed issues and challenges by board of directors and enable them to make proper strategies to improve the performance of banks which ultimately result to increase EPS. The relationship of CAR and EPS is found negatively insignificant which is consistent with previous study (alam and akhtar 2017), It may communicate us that quantum of maintaining minimum required capital with banks doesn't affect EPS. Similarly empirical result shows that gross non-performing assets is found negatively insignificant relationship with EPS and revealed that non-performing assets of banks doesn't have relationship with the performance of banks through EPS. Lastly, table 2 show that dividend payout ratio is perfectly positive significant relationship with EPS which is consistent with the studies of (Khan & Qureshi 2018 and Khan & Shamim 2017) and revealed relevant dividend policy in selected Indian banks.

### Conclusion

The recent crisis in Indian banking sector whether public or private banks raised much concern about the functioning of banks through corporate governance in Indian banking sector which may leads to regulators think about the existing legal requirements concerning about the norms of composition of board comprises of independent directors, number of board meetings, capital adequacy requirement. The present study is based on pooled panel data of eight Indian commercial banks for a period of 10 years from 2009 to 2019. In this comprehensive study three parameters of corporate governance mechanism and two bank's specific parameters has been used to see their impact on the performance of selected banks through earning per share. We find frequency of board meeting and dividend payout ratio are positively significant with EPS. In short it is concluded that frequent board meetings and dividend payout ratio matter for the performance of selected banks. More and more board meetings may lead to the indication of good governance of banks and more and more dividend payment will find its way to dividend relevant theory where dividend policy held responsible for the performance of banks.

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