Journal of Information Systems Engineering and Management
2025, 10(33s)
e-ISSN: 2468-4376
https://www.jisem-journal.com/

Research Article

Impact of Corporate Governance on Financial Performance of banking companies: A Study on Selected Public Sector Banks in India

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ARTICLEINFO

Received: 30 Dec 2024

Revised: 12 Feb 2025

Accepted: 26 Feb 2025

ABSTRACT

Introduction
corporate governance describes the procedures, policies, relationships and methods through which boards of directors, managers, shareholders, and other stakeholders oversee and run businesses.
Objectives
This study examines ways to stabilize and enhance the financial performance of India's commercial public sector banks. More precisely, this study sought to evaluate how corporate governance affected financial performance in terms of operating efficiency, asset quality and equity utilization efficiency.
Methods
Board-specific governance system characteristics and industry-specific performance are included in this analysis. Additional characteristics covered include the gender diversity of the board, its composition, risk assessment, board control, and the presence of significant board committees. To determine the causal-effect relationship between the research variables, a multiple linear regression technique is used, the data from annual reports of the top 5 commercial public sector banks over a ten-years period.
Results
The results showed that performance indicator i.e. operating profit, return on assets and return on equity have no impact on corporate governance system in banking industry.
Conclusion
The present guidelines/ governance practices for banking management have not significance relationship with performance of sample banks. The suitable guideline and mandatory framework should be revised/ implemented for enhancement of financial performance of banking sectors.
Keywords: corporate governance, Board-specific, board committees, operating profit.

INTRODUCTION

Corporate governance is the system through which a board of directors controls, regulates, and guides a company. It helps a business to establish trust, confidence, and enduring relationships with its stakeholders, including customers. Under paragraph 49 of the listing agreement, the Security Exchange Board of India has outlined a number of required and optional requirements for the firms to agree on corporate governance.

"Clause 49" refers to the 49th clause in the Listing Agreement between a firm and the stock exchanges that list it. This paragraph, which was included as late as 2000 with the intention of improving corporate governance in all listed corporations in response to the recommendations of the Committee on CG, which was led by Kumar Mangalam Birla and approved by SEBI in 1999, which is a crucial and strong addition to the Listing Agreement.

It is a significant occasion in Indian corporate governance, establishing both statutory and optional standards that companies must or may adhere to. A new issue that is necessary to establish a standard for evaluating company performance at the national and worldwide levels is corporate governance. Shareholder interest, executive and non-executive directors' responsibilities, director compensation, audit, and accountability are all pillars of corporate governance.

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The Indian financial system, which balances the Indian economy, is connected by Indian banks. Due to external incompetence, the banking and non-banking financial industries went through a serious inventory crisis. For microfinance companies, corporate governance is essential since startups with banks appear to be more accountable for development Iqbal et al. (2019) and Bezawada (2020).

According to study, inadequate corporate governance frameworks and procedures contribute to poor risk management in the banking sector, which ultimately results in unsatisfactory financial performance (FP) and the failure of the banking sector (Tarchouna et al., 2022). According to Velliscig et al. (2022) and Thaker et al. (2022), poor corporate governance is linked to low-quality assets held by commercial banks, which has a detrimental influence on performance.

In terms of the Reserve Bank's participation in banking-related governance problems, the public and private sector banks that make up the Indian banking system differ significantly from one another. In terms of economic considerations, the existing regulatory structure generally guarantees consistent treatment of private and PSBs. However, because they are governed by the laws under which different PSBs were established, some of their governance features—even though they have an impact on financial aspects—are not subject to the applicable requirements of the Banking Regulation Act. In general, the RBI's strategy has been to guarantee, to the greatest extent feasible, consistent treatment of private sector banks and PSBs with respect to prudential regulations.

In developing nations like India, empirical research on this topic is still in its infancy. This could be because of the lack of data or the limited transparency procedures that businesses apply.

1.2 CORPORATE GOVERNANCE AND FINANCIAL MATRIX

In the context of developed nations, the connection between corporate governance and firm performance has been a highly debated and widely researched subject. The amount of research on the connection between corporate governance and firm performance has expanded within the last 20 years. However, industrialized economies have been the primary focus of research on the topic (Guest, 2008).

1.3 OBJECTIVES OF THE STUDY

- To establish the link between corporate performance and the corporate governance system.
- To investigate how corporate governance affects business performance of Indian banking companies.

1.4 HYPOTHESIS OF THE STUDY

H_{01}= Operating profit and corporate governance parameters aren't significantly correlated.

H_{02}= Return on assets and corporate governance parameters aren't significantly correlated.

H_{03}= Return on equity and corporate governance parameters aren't significantly correlated.

H_{04} = There is no significant impact of corporate governance factors on Operating Profit.

H_{05} = There is no significant impact of corporate governance factors on Return on Assets.

H_{06} = There is no significant impact of corporate governance factors on Return on Equity.

1.5 VARIABLES DESCRIPTION

Operating Profit (OP)

It is the profit a business that makes from its main operations, before expenses like taxes and interest are excluded. It shows how efficiently a company generates profit from its regular activities before considering financial and tax expenses. It is calculated: Operating Profit=Revenue−Operating Expenses.

Return on Assets (ROA)

It is a crucial financial metric that evaluates the profitability of an organization in proportion to its total assets. A higher ROA indicates that the company is using its resources profitably. Inefficiency or high asset expenses in relation to earnings are indicated by a lower ROA. It is calculated: Net Income/ Total Assets.

Return on Equity (ROE)

It is a crucial financial indicator that assesses how profitable a business is in relation to shareholder equity. Investors are evaluated a company's profitability by looking at its ROE. It is calculated: Net income/ shareholders' equity.

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General Board meeting (GBM)

Regular meetings of boards of directors are believed to enhance corporate performance and ensure that their duties are performed in a manner that benefits shareholders. (Conger et al., 1998). Annual board meetings also incur hefty costs such as managerial time, directors' salaries, etc. It is calculated: by adding all board meeting.

Audit Committee meeting (ACM)

According to Klein (2002) Businesses with regular, independent Audit Committee meetings experienced higher ROE and ROA. According to Al-Matari et al. (2014) Businesses with active audit committees showed better financial performance and earnings quality. It is calculated: total no. of audit committee meeting.

Risk management committee Board (RMCB)

It is an essential component of a company's Board of Directors, which is in charge of recognizing, evaluating, and reducing risks that can have an influence on how the organization is run. Its function is particularly crucial for guaranteeing sustainability over the long run and regulatory compliance.

Stakeholder relationship committee (SRC)

It is essential to maintaining open lines of communication and goodwill amongst a business's constituents, including investors, shareholders, staff, clients, authorities, and the general public.

Special Committee for Monitoring Large-Value Fraud (SCMF)

It is an essential governance board of a company, particularly in big businesses and financial institutions. Its main responsibility is to identify, look into, and reduce fraud risks in order to maintain regulatory compliance and financial stability.

1.6 RESEARCH DESIGN

This study consists of top 5 public sector banks in India i.e. State Bank of India, Bank of Baroda, Punjab National bank, Union Bank and Canara Bank as per their market capitalization, over the period of 10 years from 2014-15 to 2023-24. The Reserve Bank of India's website, annual reports, and other previous publications are the sources of the data for this study. OP, ROA and ROE are considered as dependent variables, while corporate governance elements, such as GBM, ACM, RMCB, SRC, and SCMF, are considered as independent variables. This study makes use of statistical methods and tools such as regression analysis, correlation matrices, and descriptive statistics.

Formulation of Model

OP = $\beta_0+\beta_1GBM+\beta_2ACM+\beta_3RMCB+\beta_4SRC+\beta_5SCMF+Ui$

ROA = $\beta_0+\beta_1GBM+\beta_2ACM+\beta_3RMCB+\beta_4SRC+\beta_5SCMF+Ui$

ROE = $\beta_0+\beta_1GBM+\beta_2ACM+\beta_3RMCB+\beta_4SRC+\beta_5SCMF+Ui$

Where, $\beta_0=$ constant

$\beta_1,\beta_2,\beta_3......\beta_5=$ slope of independent variables

Ui= Error Term.

1.7 DATA ANALYSIS AND INTERPRETATION

This study includes top 5 public sector bank's in India over the period of 10 years. This study uses different statistical techniques like descriptive, correlation and regression to justify the objectives.

Table No.-1 Descriptive results of sample bank's

	N	Minimum score	Maximum score	Mean score	Std. Dev.
GBM	50	2.30	3.09	2.7316	0.18048
ACM	50	1.39	3.14	2.5119	0.25084
RMCB	50	0.69	2.30	1.6276	0.41772
SRC	50	0.00	2.40	1.1707	0.63679
SCMF	50	0.69	2.30	1.5813	0.30567

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OP	50	-08.74	11.45	9.2570	2.77213
ROA	50	-1.60	1.17	0.1778	0.61251
ROE	50	-29.54	18.13	2.6900	10.61757

Source: self-compiled

Interpretation: Table no. 1 describes overall governance and financial performance of top 5 Indian public sector banks over the period of 10 years from 2014-15 to 2023-24. Here the mean score indicates the performance matrix of governance system and financial system of sample banks. This study indicates general board meeting shows high value i.e. 2.73 then other governance factors whereas operating performance is high value i.e. 9.25 then other financial matrix.

1.7.1: Relationship between corporate governance and financial performance

In this study the we establish the relationship between corporate governance and financial performance of banking sectors. For this objective correlation matrix is used.

Table No.-2 Correlation Matrix

		GBM	ACM	RMCB	SRC	SCMF	OP	ROA	ROE
GBM	Pearson Correlation	1							
	Sig.								
ACM	Pearson Correlation	0.307*	1						
	Sig.	0.030							
RMCB	Pearson Correlation	0.130	0.135	1					
	Sig.	0.368	0.350						
SRC	Pearson Correlation	-0.128	-0.233	-0.676**	1				
	Sig.	0.375	0.104	0.000					
SCMF	Pearson Correlation	-0.171	-0.222	0.345*	-0.265	1			
	Sig.	0.236	0.121	0.014	0.063				
OP	Pearson Correlation	0.117	0.124	0.075	-0.055	-0.089	1		
	Sig.	0.418	0.389	0.603	0.706	0.540			
ROA	Pearson Correlation	-0.203	-0.009	-0.032	-0.153	-0.068	0.337*	1	
	Sig.	0.156	0.949	0.826	0.290	0.641	0.017		
ROE	Pearson Correlation	-0.231	-0.046	-0.055	-0.122	-0.053	0.323*	0.996**	1
	Sig.	0.106	0.753	0.702	0.397	0.713	0.022	0.000	

Source: self-compiled

Interpretation: Table No. 2 indicates correlation matrix of dependent and independent factors. The significant value of governance parameter i.e. GBM, ACM, RMCB, SRC, and SCMF is 0.41, 0.38, 0.60, 0.70 and 0.54 respectively with reference to operating profit. Here the significant values are higher than the critical value i.e. 0.05. Hence the null hypothesis (H_{01}) is approved. It comes to conclude that there is no significant association of corporate governance factors with operating profit.

The significant value of governance parameter i.e. GBM, ACM, RMCB, SRC, and SCMF is 0.15, 0.94, 0.82, 0.29 and 0.64 respectively with reference to return on assets. Here the significant values are higher than the critical value i.e. 0.05. Hence the null hypothesis (H_{02}) is accepted. It comes to conclude that there is no significant association of corporate governance factors with return on assets.

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The significant value of governance parameter i.e. GBM, ACM, RMCB, SRC, and SCMF is 0.10, 0.75, 0.70, 0.39 and 0.71 respectively with reference to return on equity. Here the significant values are higher than the critical value i.e. 0.05. Hence the null hypothesis (H_{03}) is accepted. It comes to conclude that there is no significant association of corporate governance factors with return on equity.

1.7.2: Impact Of Corporate Governance on Corporate Performance:

In this study, we examine whether corporate governance elements affect financial performance. Regression analysis is utilized to support objective 2 and the hypotheses (H04, H05, and H06).

Table No.-3 Regression Results: Operating Profit

Model		R	R^2	Adj. R^2	Std. Error
		0.178ᵃ	0.032	-0.078	2.87861
ANOVAᵃ					
	Sum of Square	**d.f.**	**Mean square**	**F**	**P- Value**
Regression	11.950	5	2.390	0.288	0.917ᵇ
Residual	364.601	44	8.286		
Total	376.550	49			
Coefficientsᵃ					
			Coefficients Beta	**t**	**P- value**
(Constant)	4.571	8.557		0.534	0.596
GBM	1.046	2.436	0.068	0.429	0.670
ACM	0.808	1.822	0.073	0.444	0.659
RMCB	0.639	1.384	0.096	0.462	0.647
SRC	0.053	0.899	0.012	0.059	0.954
SCMF	-0.824	1.526	-0.091	-0.540	0.592

Source: self-compiled

Interpretation: Table No. 3 shows that impact of corporate governance system on operating profit. The R value is 0.17 which means there is a very low positive association between corporate governance system and operating profit. Here the R square value is 0.032 which indicates the operating profit is 3.2% influenced by corporate governance factors. The ANOVA table indicates that the significant value is 0.917 which is higher than the critical value i.e. 0.05. As a result, the null hypothesis H_{04} is approved. It comes to the conclusion that operating profit is not significantly affected by the corporate governance system.

Table No.-4 Regression Results: Return on Assets

Model		R	R^2	Adj. R^2	Std. Error
		0.345ᵃ	0.119	0.019	0.60671
ANOVAᵃ					
	Sum of Square	**d.f.**	**Mean square**	**F**	**P- Value**
Regression	2.187	5	0.437	1.188	0.330ᵇ
Residual	16.196	44	0.368		
Total	18.383	49			
Coefficientsᵃ					
			Coefficients Beta	**T**	**P- value**
(Constant)	3.863	1.803		2.142	0.038
GBM	-0.820	0.513	-0.242	-1.596	0.118
ACM	-0.059	0.384	-0.024	-0.154	0.879
RMCB	-0.274	0.292	-0.187	-0.939	0.353
SRC	-0.340	0.189	-0.354	-1.794	0.080

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SCMF	-0.287	0.322	-0.143	-0.892	0.377

Source: self-compiled

Interpretation: Table No. 4 indicates how the business governance framework affects the ROA. The corporate governance system and ROA have a marginally positive correlation, as indicated by the R value of 0.34. Here the R square value is 0.119 which indicates the return on assets is 11.9% influenced by corporate governance factors. It also indicates that the calculated value is 0.330 which is higher than the critical value i.e. 0.05. Hence the null hypothesis H_{05} is supported. It comes to the conclusion that the corporate governance structure has no impact on ROA.

Table No.-5 Regression Results: Return onEquity

Model		R	R^2	Adj. R^2	Std. Error
		0.346ᵃ	0.120	0.020	10.51281
ANOVAᵃ					
	Sum of Square	**d.f.**	**Mean square**	**F**	**P- Value**
Regression	661.064	5	132.213	1.196	0.327ᵇ
Residual	4862.844	44	110.519		
Total	5523.908	49			
Coefficientsᵃ					
			Coefficients Beta	**t**	**P- value**
(Constant)	70.361	31.250		2.252	0.029
GBM	-15.035	8.897	-0.256	-1.690	0.098
ACM	-1.971	6.653	-0.047	-0.296	0.768
RMCB	-5.015	5.056	-0.197	-0.992	0.327
SRC	-5.554	3.284	-0.333	-1.691	0.098
SCMF	-4.417	5.574	-0.127	-0.793	0.432

Source: self-compiled

Interpretation: Table No. 5 shows that regression analysis of corporate governance features and ROE. A low positive correlation between the corporate governance system and ROE is indicated by the R value of 0.346. Here the R square value is 0.120 which indicates the return on equity is 12.0 % influenced by corporate governance factors. The ANOVA table indicates that the probability value is 0.327 which is higher than the critical value i.e. 0.05. Hence the null hypothesis H_{06} is accepted. It comes to the conclusion that the corporate governance system has no impact on ROE.

1.8 CONCLUSION

This study focuses the influence of corporate governance on performance of Indian banking sector. It concludes that performance indicator i.e. OP, ROA and ROE has not affected by corporate governance in sample banks due to variation in governance reporting practices. The study found that there is low degree of influence of corporate governance on performance of sample banks. Hence the present guidelines/ governance practices for banking management have not significance relationship with performance of sample banks. The suitable guideline and mandatory framework should be revised/ implemented for enhancement of financial performance of banking sectors.

1.9 RESEARCH GAP

This study leaves a room for further research, firstly this study is focused on Indian context. Secondly the sample size is small. Thirdly this study is considered only banking industry.

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