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An Empirical Study on the Impact of Corporate Governance Practices on Performance of Banks across BRICS Nations

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Abstract: *This study explores the relationship between corporate governance practices and its impact on the banking sector. The study is specifically aimed towards the evaluation of the data relevant to financial performance pertaining to the banks of BRICS economies as over the time various studies have shown that the BRICS economies are some of the fastest emerging economies in the world. The extent to which corporate governance practices such as board composition, size, no. of board meetings etc. have an overpowering impact on the financial performance of top banks in the BRICS nation have been analysed here. The cornerstone of this study is BRICS category as these large upcoming economies offer unique and exceptional opportunities for growth and therefore the scope of good corporate governance practices and its impact on the banking sector in these economies will be a much useful area of research.*

JEL Classification Code: M14

Keywords: *Governance, Banking, BRICS nations.*

1. INTRODUCTION

In the current age of globalisation, corporate governance has gained further momentum as an established practice for ensuring efficiency in the corporate world. Corporate governance codes have been applied to ensure greater transparency in corporate governance practices so that the stakeholders can be sure of the well-being of corporate houses and that their investment is in safe hands. Corporate governance covers various aspects like the appointment of board of directors, management, the role of different stakeholders in ensuring good governance, setting of company's strategic aims, planning the implementation and execution of company objectives, specifying the role of effective leadership in stewarding the company in the right direction, overall supervision of the board's performance including reporting to shareholders. All these aspects are monitored to enable good corporate governance.

The corporate world in the last decade was rocked by scandals and crisis emerging due to ill corporate governance and unethical corporate practices of top-level management in big corporate houses like Satyam, Lehman brothers, World Com, Enron etc. Such an occurrence further cemented the growing significance of good corporate governance and code of conduct for the board of directors as well as their obligation towards ensuring transparency for the well-being of shareholders and other stakeholders (Bhardwaj and Rao, 2014).

Corporate governance as defined by the OECD (Organisation for Economic Co-operation and Development) is the procedure of specifying the structure of rules and procedures of decision making, elucidating the processes of directing and controlling an organisation. It involves the systematic distribution of rights and responsibilities among the different stakeholders in the organisation, i.e. the shareholders, the board of directors, managers etc. (Bhardwaj and Rao, 2014).As per the Cadbury Committee (1992), "Corporate governance is the system by which companies are administered and controlled. Good governance within the companies is a responsibility of the board of directors. The shareholder's role in governance is to appoint the directors and the auditors to satisfy themselves to ensure that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meeting."

Research works in the past have indicated that factor like the size of boards, the presence of outside directors and the overall composition of the board of directors have a huge impact on the governance of any institution (Dey&Chauhan, 2009). An external representation on the board of directors of a company is also considered to

create a huge impact on the corporate governance procedures in the present times. Such outside affiliates who are not the employees or internal members of the company play an important role in increasing transparency and accountability of the corporates. They contribute to better corporate governance with their skills, expertise, knowledge and affiliation, recognition, name when associated with the organisations under the title of Independent directors (Pearce and Zahara, 1992).

The size of the board is relevant to monitoring and controlling the board as it is believed that an increased number of directors would lead to better administration and supervision. With better control and monitoring, greater efficiency and credibility is sought in governance. However, an oversized board is likely to affect firm's performance in a negative manner. Using data from 452 large U.S. industrial corporations between 1984 and 1991, Yermack (1996) documents a negative relationship between board size and firm performance, as measured by Tobin's Q and profitability. Other US studies have found very similar results (Huther, 1997; Cheng et al., 2007; Coles et al., 2008).

The study by Dahya&McConnel(2003) examined the board composition, corporate performance in wake of the Cadbury committee recommendation by using Public firms in the UK for their research. Various other studies conducted on board composition and corporate performance prior to this period was in the context of the developed economies like the US. In this paper, we will analyse the effects of corporate governance practices like board composition, size, etc. in relevance to the BRICS nation.

Jim O'Neil, the former chief economist of Goldman Sachs constituted the term "BRIC" in 2001 as a means of referring to the developing economies of Brazil, Russia, India and China. The report suggested that in the next 40 years the Gross National Product(GNP) of these large emerging economies represented by the BRICS acronym would surpass the Gross National Product of the six advanced and developed industrial economies of US, Japan, Germany, Britain, France and Italy. This has cropped a huge interest in the growth of these emerging economies since then and the same is being observed and followed all over the world. The structure of governance and state of infrastructure and development in all these BRICS countries is different to each other, yet there is a similarity in the scope of their potential for increased industrialization and growth in all major sectors of their economies (Armijo, 2007).

The BRICS category is significant to our research as these large upcoming economies offer unique and exceptional opportunities for growth and therefore the scope of good corporate governance practices and its impact on the banking sector will be a much used area of research.

2. PROBLEM STATEMENT

This study is aimed at determining the degree to which corporate governance practices have an impact on the financial performance of banks of the BRICS nations As can be seen, several previous researches conducted by Kandukuri et al.(2015),Farhan A.(2017)have tried to establish a relationship between corporate efficiency and various factors like board size, education level of board of directors, presence of external directors on the board, appointing board committees, the appointment and rotation of external auditors, and creating a whistle-blowing mechanism etc. In this study, we will examine these parameters in relevance to the banking sector of five BRICS economies. The Cadbury company report, 1992, recommended the presence of at least three outside directors on the board of public companies to ensure better governance. As per the report, a significant change in the performance and functioning of the board was achieved as a result of this practice.

Several studies were conducted to establish this relationship between the performance of the board, its size and composition and their efficiency in corporate governance in the backdrop of corporations located primarily in the developed countries like the United States of America. These studies had failed to establish a direct effect of the presence of outside directors on the board and efficiency in governance or performance of the firm (Andres, Azofra, Lopez, 2005). However, after the Cadbury committee report, many UK firms started appointing external directors to improve the board's performance. In this paper, we will evaluate the regulatory framework of the internal governance system in the banking sector and conduct cross-country comparisons for the BRICS nations. Aspects of corporate governance like the size of the board, impact of the duality of CEO, presence on independent directors in the board, Frequency of Board meetings and their influence on the banks' performance will be compared and their link to the financial performance will be established.

3. RESEARCH OBJECTIVE

The research seeks to achieve the following objectives:

- To conduct a cross-country comparison among the BRICS nations pertaining to the corporate governance practices adopted by their banks.
- To study the impact of the Corporate Governance practices adopted in the banking sector on each bank's financial performance.
- To establish the relationship between corporate governance practices and financial indicators.

4. LITERATURE REVIEW

The literature review on corporate governance influenced by size and composition of the board, and other factors like presence of external directors etc. present a mixed view on the relation between Corporate Governance and Performance.

In the words of Roy (2016) Existing empirical literature that was concerned with Corporate Governance and its impact on firm performance has not been able to establish a profound relationship between Corporate Governance and firm performance. However such researches have produced mixed results. While some researches have proved the positive impact of a large board size on the performance, some have failed to establish any such relationship between the two variables due to inefficiencies owing to large sized boards. Reddy, Locke &Scrimgeour(2010) in their study found that principle based corporate governance practices had a positive influence on the firm's financial performance. This study implicates the correlation between the principle-based corporate governance practice recommendations made by the NZSC committee in 2004 and provided some useful insights.

Responsible business practices towards various primary stakeholders were shown to have a positive impact on the listed firms' FP(Financial performance) and NFP(non-financial performance) in a research conducted by Mishra &Suar(2010), published in the journal of business ethics. They conducted a study taking six primary stakeholders into account that are employees, customers, investors, suppliers, community and environment. Their findings reflected a positive impact being created on the firms FP through CSR and responsible business practices. However, in this study, it was observed that the stock listed firms showed the better relation of FP, NFP and responsible business practices than the non-stock listed firms.

Independent directors induce credibility to the company's board and improved governance. Efficiency and effectiveness of the corporate governance are positively influenced by such appointments. However, these appointments must be reviewed periodically, and the act of their inclusion and impact on firm's performance need to be evaluated continually as discussed in a research by Prasanna (2006).

In 2014, a study was conducted by Latif et al. (2014) that aimed at examining the impact of corporate governance (Board Size, Board Structure, Leadership Style and Board Meetings) on firm's financial performance (ROA, ROE and PM) in family and non-family controlled firms listed in Karachi stock exchange Pakistan. The results of this study established that separate leadership styles and the board size have a direct and significant positive impact on firm's performance whereas the other two parameters, i.e. the board meetings and the structure of the board negatively impacted performance.

Masulis, Wang and Xie (2012), examined the effects of globalising the board room on firms performance. The study was conducted to understand the effects of getting FIDs on board. The idea was to study the impact of the appointment of FIDs in US Corporations on corporate governance and firm's performance. The results of this particular study showcased a direct positive relationship between better foreign acquisitions and appointment of FIDs on board. About 13% of US corporations had FIDs and their presence helped the firms make better cross-border acquisitions. However, the study also established that FIDs had a poor average effect on firm's performance. FIDs were only positively impacting a firm's performance during FIDs regional acquisitions. Moreover, FIDs reduce the board effectiveness regarding controlling, monitoring, and disciplining of CEOs. It also shows a negative impact on cost structure as the remuneration of FIDs is generally higher. FIDs also showcased poor attendance records for

board meetings. Therefore, it was observed that this study instituted a mixed impact of corporate governance practice of employing external directors on the firm's performance. The limitation of this study is that it only considered one aspect of corporate governance practices and did not consider the impact of other practices in its purview such as CEO remuneration, board composition, size and education background etc.

Another study on ownership structure and corporate governance were conducted by Ghazali(2010) to analyse the effects on corporate performance in Malaysia. The findings of this study were that no statistical impact could be established on the corporate performance by variables of corporate governance.

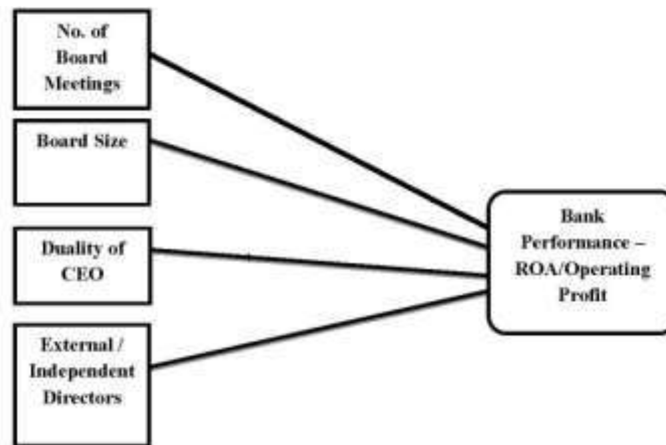

Figure 1: *Conceptual Framework (Independent & Dependent Variable)*

Hypotheses for Study

$H_0$1: There is a significant positive impact of No. of Board Meetings on the bank's ROA

$H_1$1: There is no significant positive impact of No. of Board Meetings on the bank's ROA

$H_0$2: There is a significant positive impact of No. of Board Meetings on the bank's operating profits.

$H_1$2: There is no significant positive impact of No. of Board Meetings on the bank's operating profits.

$H_0$3: There is a significant positive impact of Board Size on the bank's ROA

$H_1$3: There is no significant positive impact of Board Size on the bank's ROA

$H_0$4: There is a significant positive impact of Board Size on the bank's operating profit

$H_1$4: There is no significant positive impact of Board Size on the bank's operating profit

$H_0$5: There is a significant positive impact of the duality of the CEO on the bank's ROA

$H_1$5: There is no significant positive impact of the duality of the CEO on the bank‘s ROA

$H_0$6: There is a significant positive impact of the duality of the CEO on the bank's operating profit

$H_1$6: There is no significant positive impact of the duality of the CEO on the bank‘s operating profit.

$H_0$7: There is a significant positive impact of Independent Directors on the bank ROA

$H_1$7: There is no significant positive impact of Independent Directors on the bank ROA

$H_0$8: There is a significant positive impact on Independent Directors on the bank's operating profit

$H_1$8: There is no significant positive impact of Independent Directors on the bank's operating profit

5. RESEARCH METHODOLOGY

The current research makes use of positivist paradigm with a quantitative approach. The research design used in this study is Descriptive Research design. The research involves the collection of secondary data from the annual reports of two blooming banks of the five BRICS nations. The data is collected scientifically through strict adherence to rules and direct observation. The sampling technique that has been used is *systematic sampling*. Two banks have been chosen from the data available with respect to banks for these five nations on the official website of relbanks based on their total assets and financial resources for the period 2007-17. The most recent time period has been chosen to lend an increased reliability and validity to the research. The corporate governance parameters will then be evaluated based on their contributions/impact on the performance of the banks (dependent variable) measured by the Return on Asset (ROA) and operating profit. Data was first recorded in *Ms Excel* and the required financial Indicators were calculated in Ms Excel itself. *SPSS software* was then used for *Statistical Analysis* by applying *regression analysis.*

6. DISCUSSION

The data related to 10 banks (2 each from Brazil, China, India, Russia and South Africa) was used to conduct the analysis. Four Corporate Governance Parameters for good governance based on an extensive literature review of studies on corporate governance taken for the purpose of this study were Board Size, Duality of CEO, Number of Independent Directors and No. of Board Meetings. The financial indicators used for measuring banks' performance are ROA (return on assets) and Operating Profit. The literature review on the relation between good corporate governance practices and performance indicate a mixed view. The results of this study present a mixed view on the impact of corporate governance practices on banks' financial performance in the BRICS economies. In this section, the results obtained are discussed, while the tables demonstrating the results and statistics are placed in the APPENDIX.

Relation between board size and financial performance (ROA and operating profit)

Starting with Brazil, data from two banks, Banco Do and Itau, have been extracted and analysed via regression analysis. Considering the ROA, it was determined that there is no significant positive impact of Board Size on the ROA of the Banco Do bank, and, in the case of Itau also, no significant impact could be identified. When considering the operating profit, there has been no impact of board size on operating profit for Banco do Brasil whereas a positive significant impact of board size on Operating Profits in case of Itau Bank could be observed on conducting the regression analysis on the relevant data using SPSS. Therefore, the study offers ambiguous results when concerned with ROA and Operating Profits and, correspondingly, no concrete relationship is established here.

Next, for China, data was extracted from two banks, China construction bank and ICBC respectively. For both of these banks, it was found that ROA is not affected by the size of the board. On the other hand, the operating profit of ICBC bank is affected by the board size and yet again, for the China Construction Bank also this revelation does not hold true. The operating profit of China Construction Bank has no relation with the board size. Therefore, the study here was not successful in establishing any association between operating profit/ROA and board size.

Nedbank and Standard Bank from South Africa were taken in this study, and the results reveal that neither ROA nor operating profit is affected by the size of the board. A partially similar result has been obtained for India, where the banks, ICICI and SBI, were taken as the sample in the study. It is found that for SBI bank, ROA and operating profit have no association with the board size. However, for ICICI bank board size has a positive significant impact on ROA but no positive significant impact of board size was found on operating profit. For Russia, VTB bank was selected as the sample, where relevant data were extracted from the annual reports of the bank. The analysis revealed that board size has no linear relation with ROA and operating profit of the bank.

Overall, the study has established no relation between the variable of ROA or operating profit and board size for the BRICS economies. When comparing with the existing literature, Jensen (1993) and Lipton &Lorsch (1992) suggest that as board size increases beyond a certain point, these inefficiencies outweigh the initial advantages from having

more directors to draw on, leading to a lower level of corporate performance.. On the other hand, in alignment with the current study, another investigation conducted by Dey&Chauhan(2009) in context of the PSUs in India also failed to establish any significant positive relationship of board composition and size on the performance of PSUs in India.

Relation between independent directors and financial performance (ROA and operating profit)

Next, this study tests the impact of independent directors on the banks' financial performance. The results fail to establish any significant positive impact of the presence of independent directors on the ROA and operating profit of all the banks in BRICS nations except for Itau Bank of Brazil where Independent directors have shown a positive significant impact on operating profits of the bank and ICICI Bank of India where Independent directors have rendered a significant positive impact on both ROA and Operating Profits. Out of a total track of 20 concerning these variables, only 3 relations analysed to establish a significant positive relation between Independent directors and Financial Performance, hence, it can be said that the analysis manifests no overall relationship between Independent Directors and Financial Performance.

The findings of this research are echoed by the findings of Andres, Asofra, Lopez(2005), and is in contrast to the results of the study by Dahya & McConnel (2003) The research applied ROA as a performance indicator along with the stock prices as another performance indicator. In case of the UK firms, a definite positive economic impact of Independent directors on corporate performance was recorded. However, this particular study's results were in the context of UK firms which is a developed capitalist economy and is different from the developed BRICS economies. The Cadbury company report, 1992, recommended the presence of at least three outside directors on boards of public companies as a means to ensure good governance. A positive influence on the financial performance by the appointment of up to seven external or independent directors in case of large listed corporations was also indicated by Reddy, Locke, Scrimgeour, 2010. As highlighted earlier, Prasanna(2006), and Masulis, Wang and Xie(2012), asserted the effectiveness of outside and independent external directors on improved governance and performance. However, the study by Masulis, Wand and Xie(2012) reflected the positive impact on performance only in case of foreign acquisitions undertaken by the companies in the presence of foreign directors during regional acquisitions.

Relation between the duality of CEO and financial performance (ROA and operating profit)

This study further failed to establish any relationship between the banks ROA or Operating profit and corporate governance parameter of the duality of CEO. It was observed that, in case of the 5 BRICS nations, the parameter of corporate governance – duality of CEO in banking institutions could not establish any concrete impact on ROA or the operating profit and due to a repetition of data, i.e. similar pattern of practice over the period of 10 years for each bank, no linear regression equation could be fitted on the corresponding data set. In contrast to this, Amin, Iftikhar & Yasir (2013) stated that CEO duality has a noteworthy association with ROI and ROE of the stock companies in Pakistan. Another study by Rashid (2010) found that the association between CEO duality and firm performance is contingent and a concrete relation between the two cannot be formed.

Therefore, the results of this research in respect to the developing BRICS economies across the banking sectors in most recent time concur with the previously established mixed view on the relation between corporate governance and performance by the various studies conducted so far in this area.

Relation between No. of Board Meetings and financial performance (ROA and operating profit)

This study was unsuccessful in establishing any significant relation between the variable- No. of board meetings of the corporate governance framework and the financial Performance determinants- ROA/ Operating Profit. Almost all the banks of the BRICS nations show an absence of any relation between the financial performance and No. of Board Meetings only except ICBC Bank of China which shows a positive significant relationship between No. of Board Meetings and the operating profit for the bank, and SBI of India where No. of board meetings show a significant positive impact on ROA and Operating Profit both. But, as seen, the majority of the banks established an absence of any positive significant impact of frequency of board meetings on the indicators of firm's financial performance, hence, it may be concluded that no such relationship exists between the variables. Also, no two banks

of the same nation showcase similar results and hence, the absence of this relationship cannot be attributed to the difference in the Corporate Governance norms within different countries.

However, the study conducted by Dar et al. (2011)highlighted divergent results as they found out frequencies of board meetings have a positive impact on firm's performance. Moreover, similar results were presented by Yasser (2011) in his study where it was concluded that frequent board meetings have a positive impact on the performance of FCF. On the other hand, Vafeas (1999) established that due to loss of efficient time in conducting the board meetings, too frequent board meetings in an organisation negatively impact its performance. According to him, there is a high cost associated with conducting these board meetings such as travel costs, meeting fees, managerial productive time and the like.

Hence, the previous studies presented two different schools of thoughts. The first one showing a positive impact on frequency of board meetings on the performance of the company and the second one contrasting this school of thought. This study contributes to the second school of thought since the majority of banks under the BRICS nations failed to institute any significant relationship between the frequency of board Meetings and Financial performance.

7. CONCLUSION

The primary objective of this research was to conduct a cross-country analysis of the corporate governance practices employed in some of the excelling banks in BRICS economies to analyse its impact on their performance. The results indicate an absence of any significant positive relationship of the four corporate governance parameters taken in this study on the financial performance for the banks. It was observed that there have been mixed results when considering the BRICS nations, however, the results of other developing economies could have produced different results and hence, this calls for a research in the said unexplored region. The impact of Board size on ROA can be further examined by other studies to understand the universality of this concept across other sectors and economies. Although it is understood through various studies conducted in this area that corporate governance practices do positively impact the performance of the boards and the corporate image and effectiveness of the company but its impact on the financial indicators of performance has so far produced mixed results. Also, several research works have been observed in this area but none of the work is all-inclusive in its approach. Most of the research works are very specific, say, to one particular region or a limited no. of parameters, Hence, the scope of the research can be broadened further by researchers to be able to establish a deep-rooted conclusion to the research problem. Therefore, more studies are needed to gain clarity in this respect as this is an aspect of corporate governance and management that is gaining importance and popularity in all countries.

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