BOARD GOVERNANCE, INTELLECTUAL CAPITAL, LIQUIDITY CREATION AND PERFORMANCE: EVIDENCE FROM THE INDIAN BANKING SECTOR

A THESIS

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Abstract

Banks play a crucial role in the financial stability and economic development of a nation. The first essay of this thesis examines the impact of ownership and board governance on bank liquidity creation in India. According to modern financial intermediation theory, banks play an important role in the economic system through liquidity creation and risk transformation. This essay develops two measures of liquidity creation namely catfat and catnonfat and examines whether ownership and board characteristics influence liquidity creation in Indian commercial banks from 2007-2008 to 2016-2017. The results highlight that for the sample period, Indian banks, on an average, created liquidity on the basis of catfat measure and destroyed liquidity when catnonfat liquidity creation measure was used. New private sector banks (NPSBs) created greatest liquidity based on catfat measure followed by public sector banks and then by old private sector banks (OPSBs). Public sector banks destroyed the least liquidity when catnonfat measure of liquidity creation was used. Board size reduced liquidity creation for NPSBs relative to public sector banks based on catfat measure. For the sample period board independence reduced liquidity creation for both NPSBs and OPSBs relative to public sector banks based on catfat measure. Higher board meetings reduced liquidity creation for OPSBs based on catfat measure whereas it increased liquidity creation for NPSBs based on catnonfat measure. Greater gender diversity in board composition in NPSBs increased its liquidity creation based on catnonfat measure whereas it reduced liquidity creation for OPSBs based on catfat measure. Thus, we find that board structure had significant influence on liquidity creation process in Indian banks. This paper raises questions such as whether it is appropriate to judge public sector banks in India based on low profitability or low capital ratios despite the fact that they are able to create liquidity in the system.

The second essay focuses on the role of corporate governance in influencing efficiency of value added in banks through their physical and intellectual capital resources. A crucial aim or intent of firm's board of directors is the value added by the enterprise or the firm (Ho & Williams, 2003). However, the past and existing studies on bank governance in India and abroad measure bank performance through financial metrics, and sometimes studies have used society related performance measures like corporate social responsibility and environmental responsibility (Frankforter *et al*., 2000). In the second chapter we examine the association between bank governance and value creation in Indian banks. Following (Ho & Williams, 2003) we attempt to identify how board governance influences total value added in banks through use of their total resources, value added through physical capital resources and value added through intellectual capital resources. Using a sample of data for 41 banks and employing Prais Winsten Regression this study finds that board independence and board meetings significantly positively influence efficiency of value added by banks through their total resources and intellectual capital resources. At the same time duality in the boards of banks negatively influences efficiency of value added through physical capital resources. Overall, the findings of the paper indicate that board governance influences performance measured in terms of efficiency of value added by banks. Our study suggests that Policy makers, regulators and bank managers should frame appropriate policies to ensure greater board independence, increase the number of board meetings and separate the position of CEO and Chairman.

The third essay of the thesis explores the linkage between Intellectual capital (IC) and profit efficiency from the theoretical considerations of resource based view and knowledge based view. Banking is a very IC intensive industry (Branco *et al.*, 2011) where IC explains significant proportion of banks performance. In the era of knowledge, banks are actively looking to identify the value created through their IC resources. Despite theoretical and empirical underpinnings of the relationship between IC and organizational performance, there has been little research on the association between IC and productivity in firms (Chen *et al.*, 2014). We examine the association between IC and banks profit efficiency in India. Using the famous resource based view and knowledge based view this paper investigates the linkages between IC and profit efficiency for Indian banks from 2005-2006 to 2015-2016. The results of OLS regression method highlights that IC plays a significant role in influencing banks' profit efficiency in India. The findings are robust to several robustness checks. Policy makers and bank managers should make attempts to exploit IC resources in banks and substantial investments should be made to increase human capital and relational capital.

Keywords- Corporate Governance, Board Structure, Liquidity Creation, Intellectual Capital, Profit Efficiency, Indian Banking Sector.

List of Abbreviations

OECD: Organization for Economic Co-operation and Development

USA: United States of America

IC: Intellectual Capital

RBI: Reserve Bank of India

PSBs: Public Sector Banks

NPSBs: New Private Sector Banks

OPSBs: Old Private Sector Banks

SBI: State Bank of India

CMD: Chairman & Managing Director

GoI: Government of India

SEBI: Securities Exchange Board of India

LODR: Listing Obligations and Disclosure Requirements

ROA: Return on Assets

VAIC: Value Added Intellectual Coefficient

CCR: Charnes Cooper Rhodes

TE: Technical Efficiency

TFP: Total Factor Productivity

NSE: National Stock Exchange

IGIDR: Indira Gandhi Institute of Development Research

CEO: Chief Executive Officer

CAR: Capital Adequacy Ratio

IDBI: Industrial Development Bank of India

OLS: Ordinary Least Squares

NNPAs: Ratio of net NPAs to net Advances

EQA: Ratio of Equity to Assets

NPAs: Non-Performing Assets

MBA: Masters of Business Administration

UK: United Kingdom

JSE: Johannesburg Stock Exchange

GCC: Gulf Co-operation Council

SENSEX: Bombay Stock Exchange Sensitivity Index

MVAIC: Modified Value Added Intellectual Coefficient

AR(1)- Autoregressive process of order 1

VIF: Variance Inflation Factor

VIC: Value Added through Intellectual Capital

VPC: Value Added through Physical Capital

FGLS: Feasible Generalized Least Squares

DEA: Data Envelopment Analysis

RBV: Resource Based View

ATO: Assets Turnover Ratio

SMEs: Small and Medium Enterprises

CMIE: Centre for Monitoring Indian Economy

HCE: Human Capital Efficiency

SCE: Structural Capital Efficiency

RCE: Relational Capital Efficiency

ASEAN: Association of South East Asian Nations

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