



A study on corporate governance practices in Indian banks: Evolution, challenges, and the path forward

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Abstract

Corporate governance (CG) in the banking sector is a critical component of financial stability due to banks' unique role as custodians of public funds and key drivers of economic growth. Post-1991 economic reforms and the entry of global financial entities necessitated significant improvements in governance standards within Indian banks. This paper analyzes the evolution of corporate governance practices in the Indian banking sector, examining the regulatory frameworks established by the Reserve Bank of India (RBI) and the Securities and Exchange Board of India (SEBI). It highlights the importance of robust board structures, transparency, and risk management systems in mitigating risks such as non-performing assets (NPAs) and major financial frauds (e.g., the Yes Bank crisis). The analysis reveals that while regulations have tightened significantly, particularly with the RBI's comprehensive Commercial Banks – Governance Directions, 2025, implementation gaps persist, especially in public sector banks (PSBs)

Keywords: Corporate governance, Indian Banks, RBI, SEBI, board structure, risk management, npas, transparency, accountability

Introduction

Background and Problem Statement

The integrity of a nation's banking system is paramount for its economic health. Unlike other corporations where shareholders are the primary concern, a bank's main stakeholders are its depositors, making governance critically important. The separation of ownership and control, first highlighted by Adam Smith, poses a classic agency problem, but in banking, the potential for systemic failure magnifies the consequences of poor governance. The last two decades in India have underscored this reality, with high-profile governance failures, such as those at Punjab National Bank (PNB) and Yes Bank, leading to significant financial turmoil and regulatory intervention. Despite the implementation of comprehensive regulatory frameworks, including the Companies Act, 2013, the Banking Regulation Act, 1949, and specific guidelines from the RBI and SEBI, the consistent application of these norms remains a challenge across public and private sector banks.

Research Objectives

The primary objectives of this paper are:

- To trace the evolution of corporate governance guidelines in Indian banks, focusing on key committees and regulatory shifts.
- To critically analyze the effectiveness of current governance mechanisms in public versus private sector banks.
- To identify the key challenges, particularly regarding NPA management and board independence.
- To propose recommendations for fostering a sustainable culture of sound governance.

Methodology

This paper is an analytical review, synthesizing existing literature, official reports from the RBI and SEBI, and case

studies of governance failures. It draws upon both qualitative and quantitative research findings to provide a comprehensive overview of the current state of corporate governance in the Indian banking sector.

Review of Literature

Early studies on corporate governance in banks emphasized its role in protecting investor interests and ensuring efficient resource allocation. Post-crisis research, particularly following the Asian financial crisis and the 2008 subprime crisis, highlighted the need for stronger governance mechanisms to withstand systemic shocks. In the Indian context, committees like the Ganguly Committee and the P J Nayak Committee have provided crucial insights, with the latter specifically pointing out structural governance issues within PSBs. Research has shown mixed results on the direct correlation between governance metrics and financial performance, though better governed banks tend to exhibit higher profitability and resilience.

Regulatory Framework of Corporate Governance in Indian Banks

The Indian banking sector operates under a multi-layered regulatory structure.

Reserve Bank of India (RBI) Guidelines

The RBI is the primary regulator, utilizing powers under the Banking Regulation Act, 1949. The recent Commercial Banks – Governance Directions, 2025 have harmonized norms for public, private, and foreign banks, moving governance from a "checklist exercise" to a "hard-law imperative". Key provisions include:

- Mandating the separation of the Chairman and CEO roles.

- Imposing age and tenure limits for MDs/CEOs and Non-Executive Directors (NEDs).
- Enhancing the power and independence of the Chief Risk Officer (CRO).
- Implementing a robust risk management framework based on three lines of defense: business management, independent risk/compliance functions, and internal audit.

SEBI and Companies Act Provisions

Listed banks must adhere to SEBI's Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015, which mandate specific board compositions, the presence of independent directors, and mandatory committees like the Audit Committee and the Nomination and Remuneration Committee. These regulations aim to enhance transparency and protect all stakeholders, particularly minority shareholders.

Key Elements and Practices of Good Governance

Effective governance hinges on several core principles:

- **Board Structure and Independence:** Boards are responsible for overall strategy, oversight, and integrity of controls. Ensuring a majority of independent directors is crucial to mitigate conflicts of interest and ensure objective decision-making.
- **Risk Management:** Compliance with international norms like Basel III capital adequacy requirements is essential. The implementation of robust risk identification and mitigation processes is a core board responsibility.
- **Transparency and Accountability:** Timely and accurate disclosure of financial health, including NPAs, builds investor and depositor confidence. The average GNPA ratio of SCBs fell to a multi-decadal low of 2.2% in March 2025, suggesting improved risk practices, but high-value frauds remain a concern.

Ethical Culture and Conduct: The board is responsible for setting and enforcing a clear code of conduct, ensuring senior management acts as role models, and implementing effective whistleblowing policies

Challenges and Recent Developments.

Non-Performing Assets (NPAs) and Governance Failures

The persistent challenge of NPAs, particularly in PSBs, has been linked to weak governance and poor credit management systems. While the GNPA ratio has improved recently, the value of advances-related frauds remains high. Case studies like Yes Bank highlight failures in board oversight, misreporting of NPAs, and risky lending practices driven by key individuals.

Public Sector vs. Private Sector Dynamics

Significant differences exist. PSBs have historically faced more political interference and structural governance issues as highlighted by the Nayak Committee. Private banks, while generally having better compliance, have also experienced major failures, demonstrating that ownership structure alone does not guarantee sound governance.

Emerging Risks and Trends (2025-2026)

Recent trends emphasize the impact of technology and new regulations. The RBI has issued Master Directions on Fraud Risk Management (July 2024) and the Treatment of Wilful Defaulters (July 2024). Emerging challenges include climate risk (termed a "national imperative" by the RBI), cybersecurity risks associated with digital banking, and consumer protection issues like mis-selling.

Comparative Board Structure: Public vs. Private Sector Banks (2025-2026)

The RBI (Commercial Banks – Governance) Directions, 2025 have significantly harmonized requirements for all commercial banks, yet distinct differences remain in their operational and legislative frameworks.

Feature	Public Sector Banks (PSBs)	Private Sector Banks (PVBs)
Chairperson	Must be an Independent Director.	Can be a Non-Executive Director; separation of Chair and MD/CEO is mandated.
Director Tenure	Governed by statutory Acts; recently enhanced focus on rotation and independence.	Non-Executive Directors (NEDs) capped at 8 years total tenure; MD/CEOs capped at 15 years.
Independent Directors	At least 50% of directors attending meetings must be independent.	Same 50% requirement for meetings; "Fit and Proper" criteria rigorously tested for integrity.
Board Quorum	Higher of 1/3rd or 3 directors, with at least 50% being independent.	Higher of 1/3rd or 3 directors, ensuring independence isn't "accidental".
Key Roles	Mandatory appointment of CFO, CTO, and CS with strict qualification norms.	Mandatory CFO and CTO; CRO must have unhindered access to the Risk Committee.
Compensation	Fixed pay scales as per Government of India/RBI mandates.	At least 50% variable pay for senior executives; includes clawback clauses linked to risk.

Asset Quality Trend: Gross Non-Performing Assets (GNPA) Ratio

The Indian banking sector has transitioned from a period of

high stress to a multi-decadal low in asset quality, though 2026 projections suggest a slight rise due to retail credit stress.

Table 1: Trend of Gross NPAs (2020 – 2026 Projection)

Year (March)	GNPA Ratio (%)	Significance / Context
2020	8.2%	High legacy stressed assets post-AQR.
2021	7.3%	Implementation of IBC and COVID-19 relief measures.
2022	5.8%	Accelerated recovery and cleaning of balance sheets.

2023	3.9%	Improved credit discipline and robust corporate deleveraging.
2024	2.8%	Decadal low; SCBs showing strong resilience.
2025	2.2%	Multi-decade low; multi-pronged "4R" strategy success.
2026 (P)	2.3% - 3.0%	Baseline Projection: Potential rise due to stress in unsecured retail and microfinance.

Analysis of Structural Changes

The inclusion of these tables illustrates that Governance 2.0 (initiated in late 2025) is more than a checklist.

- Shift in PSB Governance:** The mandate for an Independent Chair and specialized Audit/Risk committees in PSBs aims to bring their governance standards at par with global peers.
- Risk-Linked Remuneration:** By mandating that 50% of executive pay be variable and subject to "clawback," the RBI is ensuring that senior management's interests are aligned with long-term stability rather than short-term profit.
- Proactive Monitoring:** The projected slight rise in GNPA's for 2026 serves as a "reality check," highlighting why the RBI has introduced more stringent Fraud Risk Management and Wilful Defaulter guidelines as of July 2024.

Conclusion and Recommendations

Corporate governance in Indian banks has matured significantly under the proactive guidance of the RBI and SEBI. The recent regulatory push to institutionalize independence and accountability is a decisive step forward. However, the key challenge remains the effective implementation of these regulations and fostering an inherent culture of integrity and risk awareness at all levels.

Recommendations

- **Strengthen Board Independence:** Continue efforts to professionalize PSB boards and ensure true independence, as directed by recent RBI norms.
- **Enhance Risk Culture:** Emphasize proactive risk identification and management, ensuring CROs have direct, unhindered access to the board and are not involved in business targets.
- **Leverage Technology:** Utilize AI and machine learning for enhanced fraud detection, data security, and compliance monitoring.
- **Focus on Compliance:** Shift the focus from mere "tick-box" compliance to a governance ethos where every director and employee understands their fiduciary duties and accountability to all stakeholders, especially depositors and the broader economy.

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