# <u>CG "Business Case"</u>

## Introduction

The DFI Working Group (link to the Working Group) on Corporate Governance created a sub-working group to examine the possible relationship between the corporate governance of financial institutions (FIs) and their financial performance. BSTDB (link to the BSTDB), FMO (link to FMO), IFC (link to IFC), and Swedfund (link to SwedFund) offered to provide CG assessments for about 15 FIs each (less so for Swedfund (link to SwedFund) due to smaller portfolio size). BSTDB (link to BSTD), which was chairing the group, offered to retrieve relevant financial data from the "Bankscope" database and run the regression analysis. Unfortunately, some Working Group (link to the Working Group) members were not able to offer their 15 institutions for the sample, therefore, finally, the size of the sample was only 30 FIs. The duration of the initiative was from May 2013 to May 2014.

## Methodology

The CG assessment tool used was a slightly amended version of the EDFI CG assessment tool and was broadly consistent with the CG Development Framework methodology (link to the CG Development Framework). In the tool used, questions regarding various CG categories related to facts and were answered in a yes/no manner, which automatically translated to a low, medium, high (risk) score. The CG assessment tool used is attached.

The following financial indicators were employed to measure financial performance:

a) Z-score= (ROA + Equity/Assets)/StDev(ROA) in order to combine an "active" indicator such as ROA with a more stable one such as Equity/Assets to denote company shareholder strength and financial performance over time, while using the standard deviation in order to "promote" consistency of performance over time and avoid the influence of extreme outliers.
b) Impaired Loans (NPLs)/Gross Loans in order gauge how well the FI manages its credit risk
c) ROA in order to determine how efficiently the FI manages its assets

## Procedure

After all CG assessments have been gathered from the participating institutions and all financial data have been collected in a central database, a regression was run in the MS Excel statistics functionality between the various CG categories and the indicators listed above to find if there is any significance between the two sets of parameters. As expected due to the small sample size, the regression did not reveal any significant relationship between the CG scores of the institutions and the financial indicators. The only relationship that yielded a relatively higher number from all others was between NPL/Total loans and the CG scores, indicating that with a stronger sample it would be beneficial to investigate further if any such relationship can be verified.

The contents of the database and the estimation outputs (regressions) are under the custody of BSTDB (link to the BSTD) and are proprietary to the DFI Working Group on Corporate Governance. They may be used by any of the WG (link to the Working Group )members or other organizations, with the explicit approval of the WG and in an anonymous format, for further study and analysis.