Key findings

Financial performance and Corporate Governance: Evidence from National Development Banks in Africa

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THE VISIBLE HAND:
Development
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National Development Banks (NDBs) have a huge potential to support their country's development efforts. However, in Africa in particular, there is a persistent perception of NDBs as weak in governance and poor in performance. Many operate in contexts of institutional weakness and problematic governance, which present challenges to both the autonomy of NDBs from political interests, and the capacity of these institutions to fulfil their given mandate.

Objectives and research questions

This study therefore examines the governance and financial performance of African development banks with a view to understanding if this perception is valid.

It also seeks to answer the question: how does the political governance of National Development Banks in Africa affect their performance?

The authors hypothesise, that *ceteris paribus*, governance arrangements that increase institutional distance between political actors and bank management leads to better performing banks.

Methods

The authors mapped the universe of African National Development Banks, and gathered panel data on governance and financial performance of a sample of 33 banks.

They explore through descriptive analysis governance and financial trends to draw insights, and then use regression methods to understand key relationships between corporate governance structures of NDBs, and their financial performance.

Results

Descriptively, the paper finds that contrary to perception, a significant majority of banks are profitable. However, most banks are small and rely on long-term debt, and high non-performing loan ratios are a key challenge in half of the banks sampled. Quantitively, the paper finds that governance structures have a significant impact on bank financial performance. In particular, the authors find that political appointment of executive management is one of the most salient variables correlated with financial performance. This effect is negative and statistically significant, and holds true when the country's overall level of governance is taken into account.

Importantly, they find that independence from political influence is important for banks that operate in countries with weak enabling environments. Moreover, governance structures have a systematic impact, not only for profitability and commercial performance of banks, but also the operational risk appetite. Less salient but still significant, they find that Board composition also matters: increasing the number of independent members has a significant and positive impact for financial performance.

Recommendations

➔ **Increase institutional distance between ownership and management:**

- Depoliticise appointments, particularly of executive management. Devolve appointment decisions to the board, reducing intervention of heads of state.
- Strengthen the board of directors through increasing number of independent members.

➔ **Ensure sufficient capitalisation of well-performing National Development Banks**, so that they can operate at scale to support transformative investments.

➔ **Push for greater transparency in reporting and publication for African National Development Banks**, where for a vast majority of banks, little information is publicly available.

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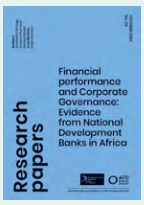

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