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# How does corporate governance impact on attracting funding?

*BICG study from 2019:*

<https://www.bicg.eu/analysis-of-cg-impact-on-bank-lending-in-latvia/>

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# Why was the study made by the BICG?

- ◆ To raise **awareness of governance requirements for companies** that want to attract funding from banks for further development.
- ◆ To understand **bank experience in Latvia**:
  - ◆ Swedbank;
  - ◆ SEB Banka;
  - ◆ Citadele;
  - ◆ Luminor;
  - ◆ Baltic International Bank.
- ◆ To understand **practical impact** of corporate governance practices on lending conditions.

# Criteria vary from bank to bank

- ◆ Large vs. small company
- ◆ Private vs. state & municipality owned enterprises
- ◆ Industries with high vs. small risks
- ◆ Few shareholders vs. dispersed ownership structure
- ◆ New company vs. company with extensive experience and track record
- ◆ Amount of funding needed more than 100 000 EUR vs. more than 1 000 000 EUR

## **2 options** **after initial assessment of possible co- operation**

**#1**

**Co-operation is  
not possible**

(compliance issues, AML, KYC,  
questionable owners, corruption  
cases etc.)

**#2**

**Co-operation is  
possible**

(not only financials and business plan, but  
also corporate governance dimension  
assessed)

# 6 corporate governance related aspects assessed by banks

Shareholders &  
ownership  
structure

Operational  
experience and  
reputation

Quality of the  
management  
team

Understandable  
decision-making

Risk governance  
and relationship  
approach to  
business partners

Transparency  
and quality of  
information

# 1. Shareholders & ownership structure

- ◆ What is the existing ownership structure? Has there been or is there a plan to change it?
- ◆ If the company has two owners and they each own 50% of shares, how will the company act and make decisions in case there is a dispute between the owners?
- ◆ Overall “picture” being assessed, including what companies do the same shareholders own?
- ◆ How do the management of the company cooperate with the owners?
- ◆ What are the owner’s (majority shareholder’s) relationship with minority shareholders?
- ◆ Do the owners and management have a vision for the company development?
- ◆ For large companies, is the management of the company separated from the owners (e.g. supervisory board with independent board members is established)?
- ◆ Are there any (unsettled) shareholders’ disputes?
- ◆ If the owners are of an advanced age, is there a succession plan in place?

## 2. Operational experience & reputation

- ◆ What is the company experience in working with the bank (credit history), does the company management comply with the terms of financing agreements, etc.
- ◆ How did the company overcome the global financial crisis or other shocks in the industry (incl. assessment of problem-solving approach, motivation to implement)?
- ◆ Has the company provided true information about the situation in the company?
- ◆ How often has there been a change of management and owners, can the company explain the rationale of such decisions?
- ◆ What are the business ethics, corporate culture and corporate social responsibility practices of the company?
- ◆ Involvement of the management and owners in corruption schemes.

### 3. Quality of the management team

- ◆ Does the company have an experienced management?
- ◆ Is the management team competent enough?
- ◆ Does the company have a “strong” CFO?
- ◆ What is the experience of the management and supervisory board members (CV, track record)?
- ◆ Is the company represented by the management or only a consultant in the negotiations with the bank?

## 4. Understandable decision-making

- ◆ Is it possible to track how strategic and operational decisions are made and who make such decisions?
- ◆ What are the strategic goals (strategy) of the company, who is approving the strategy?
- ◆ Does the company's actual manager run the company? Are all the important decisions made by the actual manager (not e.g. owner)?
- ◆ The larger the company, the greater the need to establish a clear governance structure with separate responsibilities: operational management and oversight (supervisory board, shareholders).
- ◆ Do the management of the company follow the decisions that are made? For example, is current situation in line with company strategy and annual budget?
- ◆ Can the company explain its decisions, disputes, shareholder and management changes, etc.

## 5. Risk governance & relationship approach to business partners

- ◆ Is the company aware of major risks? For example, operational, IT, industry-specific risks, buyers, commodities, currency and price volatility risks, risks in the regulated sectors, etc.
- ◆ How are risks governed in the company and who is responsible for it?
- ◆ How are related party transactions implemented?
- ◆ What is the quality of the external auditor? Does it fit the size of the business?
- ◆ Larger companies have higher requirements:
  - ◆ Is there a risk governance system in place? What are the internal procedures for controlling risks and debtors?
  - ◆ What is the risk appetite of the company?
  - ◆ How professional and independent is internal audit?
- ◆ How are business partners assessed, what is the sanction management policy?
- ◆ Does the company pay salaries significantly below average in the industry?

## 6. Transparency & quality of information

- ◆ Is there any publicly available information about the company (e.g. information on its website about company goals, ownership structure, etc.)?
- ◆ Are internal reports (including financial) available and sufficient? Are cash flow, pricing mechanism understandable?
- ◆ Does the company have an annual report (or other reports), are they prepared in a timely manner?
- ◆ What is the quality of the information provided?
- ◆ Is the company able to provide the required additional information (such as info on debtors)?
- ◆ How is corporate social responsibility defined by the company? What are the sustainability goals, how are the negative environmental and social impacts identified, how are these negative impacts mitigated?

# Practical impact

Impact of corporate governance practices on the company credit rating is **10 to 25 percent**

Poorly governed companies will be subject to...

- ◆ **Higher interest rates** (up to 2,5 percentage points or more);
- ◆ Ensuring **higher own contribution**;
- ◆ **More intensive monitoring and control regime** by the banks, such as being required to submit more regular reports, discuss financial plans more frequently, receive consent for certain investments.

# Conclusions

- ◆ When we see scandals, crises and corporate disputes, very often the **root of the problem lies precisely in the corporate governance model**.
- ◆ There are often such situations when a company is growing fast but the **corporate governance model is not adapted** (refined).
- ◆ If a company has good governance and professional management, the **credibility of financial forecasts** provided by the company increases significantly.
- ◆ If the relationship between owners, board, management and stakeholders is not well defined within the company or there is a **weak corporate governance discipline**, incl. risk governance, there are often situations where everyone “pulls the blanket to their side”. In such a case, the risk associated with financing the business increases.
- ◆ If the **quality of the information** provided by companies is questionable or non-existent, banks and investors will be very cautious in developing cooperation and investing funds.



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**Thank you!**

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