Evaluation of Corporate Governance Effectiveness in the Banking System of the Republic of Armenia

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Introduction

In the modern banking system, the effectiveness of corporate governance serves as a critical prerequisite for ensuring financial stability, accountable management, and long-term sustainable development. The growing complexity of banking operations alongside the expanding expectations of stakeholders enhance the need for an objective evaluation of governance systems. In this context, the objective of this study is to develop and implement a composite methodology for assessing corporate governance effectiveness specifically tailored to the banking sector of the Republic of Armenia.

Methodology

As a result of the study, five key components evaluating corporate governance effectiveness have been identified:

1. Board of Directors effectiveness,
2. Internal control effectiveness,
3. Transparency and disclosures,
4. Protection of shareholder rights and interests,
5. Integration of sustainable governance.

Each of these components is evaluated through five sub-components. The expert survey method is applied to calculate the index. The questionnaire is designed for representatives of banking management at various levels. The questions are rated on a 1-5 scale (1 – absent, 2 – formal application, 3 – partial implementation, 4 – established system, 5 – alignment with international best practices. The score for each component is calculated as the average value of its five respective indicators.

$$C_i = \frac{\sum_{j=1}^{5} X_{ij}}{5}$$

where:
C_i- is the score of the i-th component,
X_{ij}- is the score of the j-th indicator of the i-th component.
As a result, each component receives a score ranging from 1 to 5.
The overall Corporate Governance Effectiveness Index (CGEI) is calculated using the equally weighted average of the five components:

$$CGEI = \frac{BE + OE + TD + SP + SGI}{5}$$

The obtained results are normalized to a range of 0-1, where they are interpreted as follows:
0 ≤CGEI< 0.4- Low effectiveness,
0.4≤ CGEI <0.7 Moderate (Medium) effectiveness,
0.7≤ CGEI ≤1 High effectiveness.

Literature review

In the literature, considerable attention has been devoted to the evaluation of corporate governance effectiveness. Various scholars have proposed governance indices and assessment frameworks aimed at measuring the quality and effectiveness of corporate governance practices. The study by Gompers, Ishii, and Metrick [2003] is considered one of the seminal works in this field. Based on data from 1,500 large corporations, the authors developed the Governance Index (G-Index), which provides a quantitative measure of shareholder rights and governance provisions. Their findings suggest that differences in governance structures are associated with significant differences in corporate valuation and performance. Bhagat and Bolton [2008] further advanced the literature by examining the interrelationships among corporate governance, ownership structure, capital structure, and firm performance. Their study highlighted the importance of considering governance mechanisms within a broader organizational and financial context when assessing governance effectiveness. Another important contribution was made by Brown and Caylor [2004], who developed the Gov-Score index consisting of 51 corporate governance provisions. Their findings indicate that stronger governance practices are associated with improved firm valuation and operating performance, demonstrating the multidimensional nature of governance quality assessment. When evaluating corporate governance, it is important to distinguish between regulatory compliance and governance effectiveness. As noted by Sahay [2016, 300], compliance with governance standards and regulations should not automatically be equated with effective governance. While compliance represents an essential prerequisite, governance effectiveness is ultimately reflected in an organization's ability to achieve its strategic objectives and generate sustainable outcomes.

Evidence from the Armenian banking sector also supports the growing importance of governance-related factors in performance assessment. Hakobyan and Margaryan [2025], examining major Armenian commercial banks within the ESG framework, found that stronger ESG integration is associated with enhanced financial resilience, improved cost efficiency, and more stable long-term profitability. The authors further report that higher governance scores are linked to stronger dividend policies and increased free cash flow.

The Basel Committee on Banking Supervision [2015] emphasizes that effective corporate governance in banks requires sound board oversight, robust risk governance, effective internal control systems, and clearly defined accountability mechanisms. These elements are regarded as essential for prudent bank management and financial stability. Similarly, the G20/OECD Principles of Corporate Governance [2023] identify transparency, disclosure, accountability, shareholder rights, board responsibilities, and sustainability considerations as key components of a sound governance framework.

Despite the extensive literature on corporate governance assessment, there is still no universally accepted methodology for evaluating governance effectiveness in banking institutions. Existing approaches differ in terms of indicators, assessment criteria, and measurement techniques. Moreover, studies dedicated specifically to the evaluation of corporate governance effectiveness in the banking system of the Republic of Armenia remain limited, highlighting the relevance of further research in this area.

Scientific novelty

Within the scope of this study, a Corporate Governance Effectiveness Index (CGEI) has been developed and empirically computed for the banking system of the Republic of Armenia. The proposed index is based on the key governance dimensions reflected in the OECD Principles of Corporate Governance [2023] and the Basel Committee on Banking Supervision Corporate Governance Principles for Banks [2015], while also taking into account the institutional and regulatory characteristics of the Armenian banking sector. Unlike existing international frameworks, which primarily provide governance principles and recommendations, the proposed approach offers a structured methodology for the quantitative assessment of corporate governance effectiveness, thereby facilitating a consistent and systematic comparative analysis of governance effectiveness across banks. The empirical application of the proposed index reveals that differences in corporate governance effectiveness among Armenian banks are driven primarily by strategic governance dimensions, particularly sustainable governance (ESG) integration, transparency and disclosure practices, and the protection of shareholder rights and interests. In contrast, internal control systems demonstrate a relatively high degree of consistency across banks, reflecting the influence of regulatory requirements. These findings contribute to a deeper understanding of the factors shaping corporate governance effectiveness in the Armenian banking sector and provide a basis for future governance enhancement initiatives.

Analysis

The proposed index is structured around the core logic of corporate governance functions, reflecting the strategic, supervisory, and accountability dimensions of management, as well as contemporary sustainable development requirements. Table 1 presents the components of the Corporate Governance Effectiveness Index (CGEI). The framework captures five key dimensions: Board of Directors effectiveness, Internal control effectiveness, Transparency and disclosures, Protection of shareholder rights and interests, and Integration of sustainable governance (ESG). Together, these components provide a multidimensional assessment of governance quality in banking institutions.

Table1. Components of the Corporate Governance Effectiveness Index[1]

Board of Directors effectiveness	Component evaluates the role of the board of directors in strategic management, oversight, and decision-making processes. It assesses board independence, the activities of board committees, the effectiveness of meetings, and the level of oversight over management.
Internal control effectiveness	Component reflects the effectiveness of risk management, internal audit, compliance, and internal control systems.
Transparency and disclosures	Component evaluates the level of financial and non-financial information disclosure, the maturity of accountability systems, and information accessibility for stakeholders.
Protection of shareholder rights and interests	Component reflects the level of shareholder rights protection, equal access to information, and the effectiveness of conflict of interest management mechanisms.
Integration of sustainable governance	Component evaluates the integration of Environmental, Social, and Governance (ESG) factors into the activities of governing bodies and strategic decision-making processes.

The methodology was applied to five commercial banks in the Republic of Armenia, based on survey data collected from 153 respondents. Table 2 reports the calculated CGEI scores for each governance component across the sampled banks.

Table 2. Corporate Governance Effectiveness Index Metrics of RA Commercial Banks[2]

Components	Bank1	Bank 2	Bank 3	Bank 4	Bank 5
Board of Directors effectiveness	4.6	4.1	3.7	4.6	3.5
Internal control effectiveness	4.8	4.7	4.6	4.8	4.5
Transparency and disclosures	4.7	4.9	3.4	3.9	3.2
Protection of shareholder rights and interests	4.4	4.5	2.6	4.3	2.5
Integration of sustainable governance	4.1	4.3	1.9	3.1	1.7
CGEI	4.5	4.5	3.2	4.1	3.1
CGEI	0.88	0.88	0.55	0.78	0.53

[1] Compiled by the author based on international corporate governance principles
[2] Compiled by the author based on the assessment results

The empirical results reveal a clear heterogeneity in corporate governance effectiveness across the sampled banks. The difference between the highest-performing and lowest-performing banks reaches 0.35 points in the normalized CGEI scale (0.88 versus 0.53), indicating a substantial governance gap within the Armenian banking sector. Such variation suggests that regulatory compliance alone does not ensure uniform governance effectiveness and that bank-specific governance practices remain critical determinants of governance quality. The component-level analysis demonstrates that Internal Control Effectiveness achieved the highest average score (4.68), indicating a relatively mature and standardized risk governance environment across Armenian banks. Conversely, Sustainable Governance Integration recorded the lowest average score (3.02), suggesting that ESG-related governance mechanisms remain insufficiently institutionalized and are not yet embedded into strategic decision-making processes. Banks 1 and 2 demonstrate consistently high performance across most governance dimensions, particularly in internal control, transparency, and board effectiveness, which results in identical overall CGEI scores (0.88). However, despite achieving the same final index value, their internal governance structures differ, suggesting that similar governance outcomes may emerge from different institutional configurations. Bank 4 also demonstrates relatively strong governance performance, though with slightly lower scores in transparency and ESG integration compared to Banks 1 and 2. In contrast, Banks 3 and 5 exhibit significantly lower CGEI values (0.55 and 0.53 respectively), indicating a moderate level of governance effectiveness and highlighting a persistent governance gap within the banking system. A notable finding of the study is the comparatively low dispersion in the “Internal Control Effectiveness” component across all banks. The relatively small variation observed in Internal Control Effectiveness (4.5–4.8) compared with the significant variation in ESG Integration (1.7–4.3) suggests that governance dimensions subject to direct regulatory oversight tend to converge across institutions, whereas strategically driven governance dimensions remain largely dependent on managerial commitment and organizational culture. This indicates a strong regulatory convergence in this area, largely driven by mandatory requirements imposed by the Central Bank of Armenia [Central Bank of Armenia, 2013]. As a result, internal control systems appear to be the most standardized governance dimension within the Armenian banking sector, with limited variation between institutions. In contrast, substantial variation is observed in the “Integration of Sustainable Governance (ESG)” component. This suggests that the integration of ESG principles is still at a developmental stage and has not yet been fully institutionalized. The observed differences may be attributed to bank-specific managerial, organizational, and strategic characteristics, as well as their respective development priorities. A particularly noteworthy observation is that banks with higher CGEI values also demonstrate substantially stronger ESG integration scores. This pattern suggests that sustainable governance practices may act as a complementary governance mechanism that enhances overall governance effectiveness beyond traditional control and compliance functions. Unlike internal control mechanisms, ESG integration is not yet uniformly embedded within corporate governance systems, reflecting a transitional phase in sustainable governance adoption.

Overall, the findings indicate that while regulatory compliance ensures a baseline level of governance quality, particularly in risk control and internal supervision, it does not eliminate structural differences in broader governance effectiveness. The CGEI results demonstrate that strategic governance dimensions such as ESG integration, transparency practices, and shareholder protection remain key differentiating factors among banks and represent the main drivers of variation in overall governance effectiveness.

Conclusions

The study highlights the importance of developing assessment tools tailored to the specific characteristics of national banking systems, as general international frameworks may not fully reflect the institutional and contextual features of local markets. The empirical results obtained through the proposed index indicate that corporate governance practices within the banking system of the Republic of Armenia are characterized by noticeable variation, reflecting different levels of governance development across institutions. The sampled banks demonstrate a range of governance effectiveness, from relatively high to moderate levels. Among the examined components, internal control effectiveness emerges as the most consistently developed dimension across the banking system. This pattern is largely influenced by the stringent regulatory requirements imposed by the supervisory authority. As a result, even banks with lower overall governance effectiveness exhibit comparatively strong performance in risk management and internal control systems. In contrast, the integration of sustainable governance (ESG) remains the least developed and least institutionnalized component. This suggests that ESG adoption is still in a transitional phase and represents a key area for further improvement in the governance systems of Armenian banks. The empirical evidence suggests that the future development of corporate governance in Armenian banks is likely to depend less on strengthening traditional control mechanisms and more on enhancing strategic governance dimensions, particularly ESG integration, transparency practices, and shareholder engagement. These dimensions appear to constitute the principal sources of governance differentiation within the sector.

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This study presents a Corporate Governance Effectiveness Index (CGEI) developed to assess the level of corporate governance effectiveness within the banking system of the Republic of Armenia. The index is informed by widely recognized international corporate governance principles, including those of the OECD and the Basel Committee on Banking Supervision, while also reflecting the institutional and regulatory context of the Armenian banking sector. The CGEI is constructed using survey-based data and enables the assessment of corporate governance effectiveness across five key components: board effectiveness, internal control systems, transparency and disclosure practices, shareholder rights protection, and ESG integration. The empirical results indicate significant variation in corporate governance effectiveness among banks, ranging from high to moderate levels. Internal control systems emerge as the most consistently developed component, largely driven by regulatory requirements. In contrast, ESG integration remains at an early stage of development and is not yet fully institutionalized. The findings suggest that strengthening sustainable governance (ESG) practices represents an important direction for enhancing corporate governance quality within the Armenian banking system.