

SME GOVERNANCE

PRACTICES FOR GROWTH AND SUSTAINABILITY



Creating Markets, Creating Opportunities

Canada 

Good Governance Premium

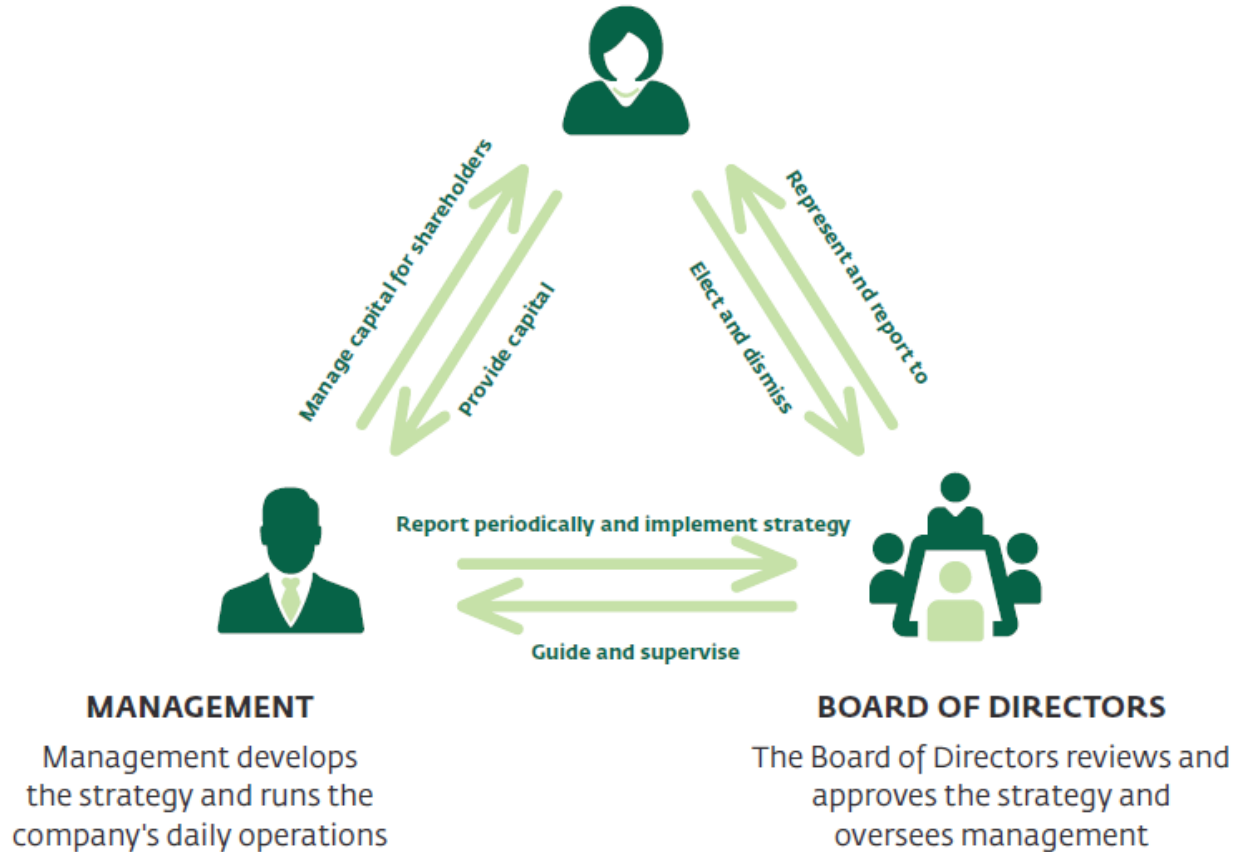
TABLE 1. THE INVESTMENT PREMIUM FOR GOOD GOVERNANCE IN EMERGING MARKETS

Statement read to 29 emerging market investment decision-makers	Percentage of respondents who agreed with statement
My firm would pay a larger governance premium for emerging market companies than for developed market companies	100%
My firm would pay a premium of at least 10 percent for good governance in an emerging market company	55%
My firm would pay a premium of at least 20 percent for good governance in an emerging market company	38%
My firm considers governance a threshold for an emerging market investment decision, and for how much of a premium we would be willing to pay	41%

Source: IFC Emerging Market Investor Survey , 2015

SHAREHOLDERS

Shareholders set the overall vision for the company



MANAGEMENT

Management develops the strategy and runs the company's daily operations

BOARD OF DIRECTORS

The Board of Directors reviews and approves the strategy and oversees management

"I am the state!"

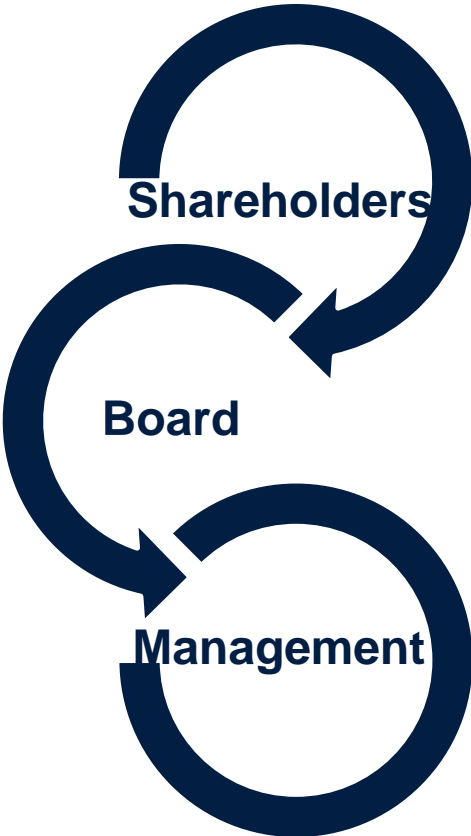
Louis XIV



What Is *SME* Governance?



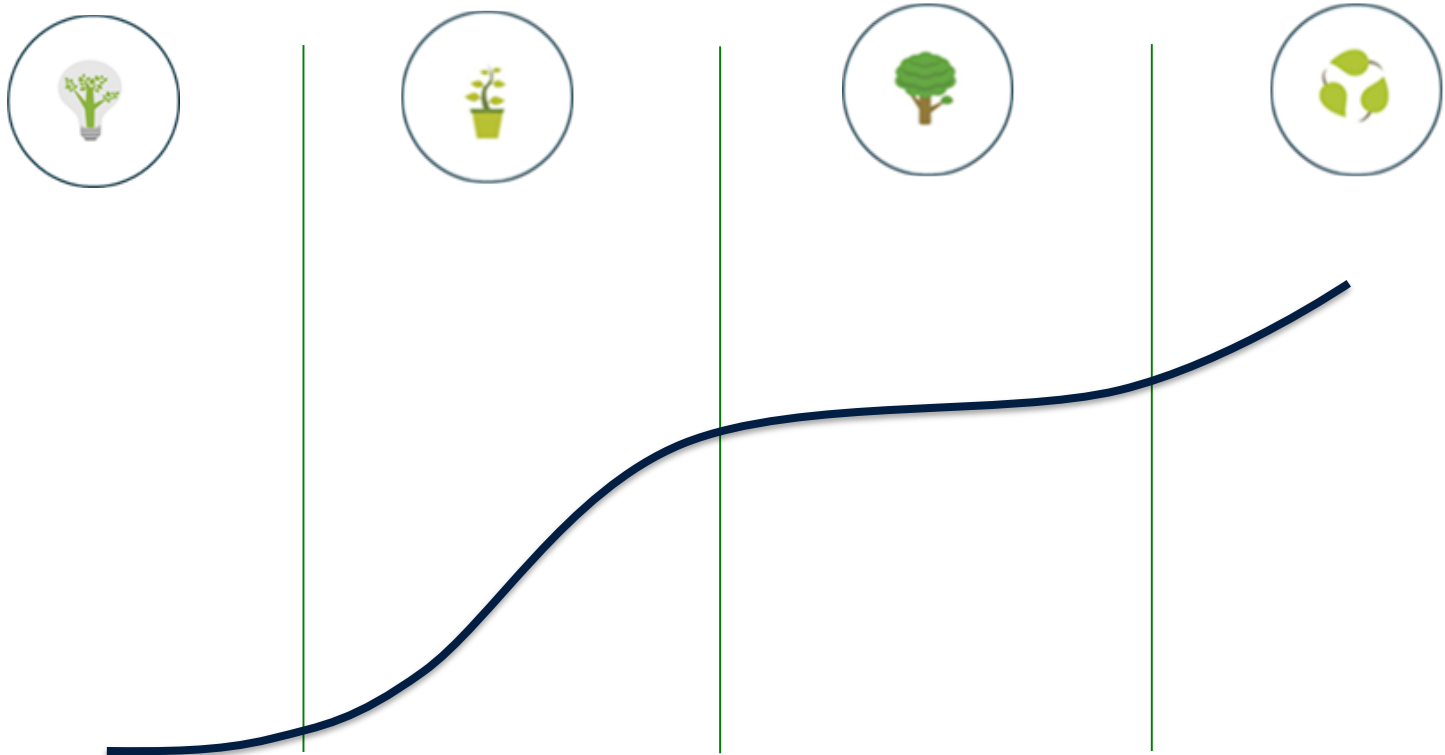
What Is *SME* Governance?



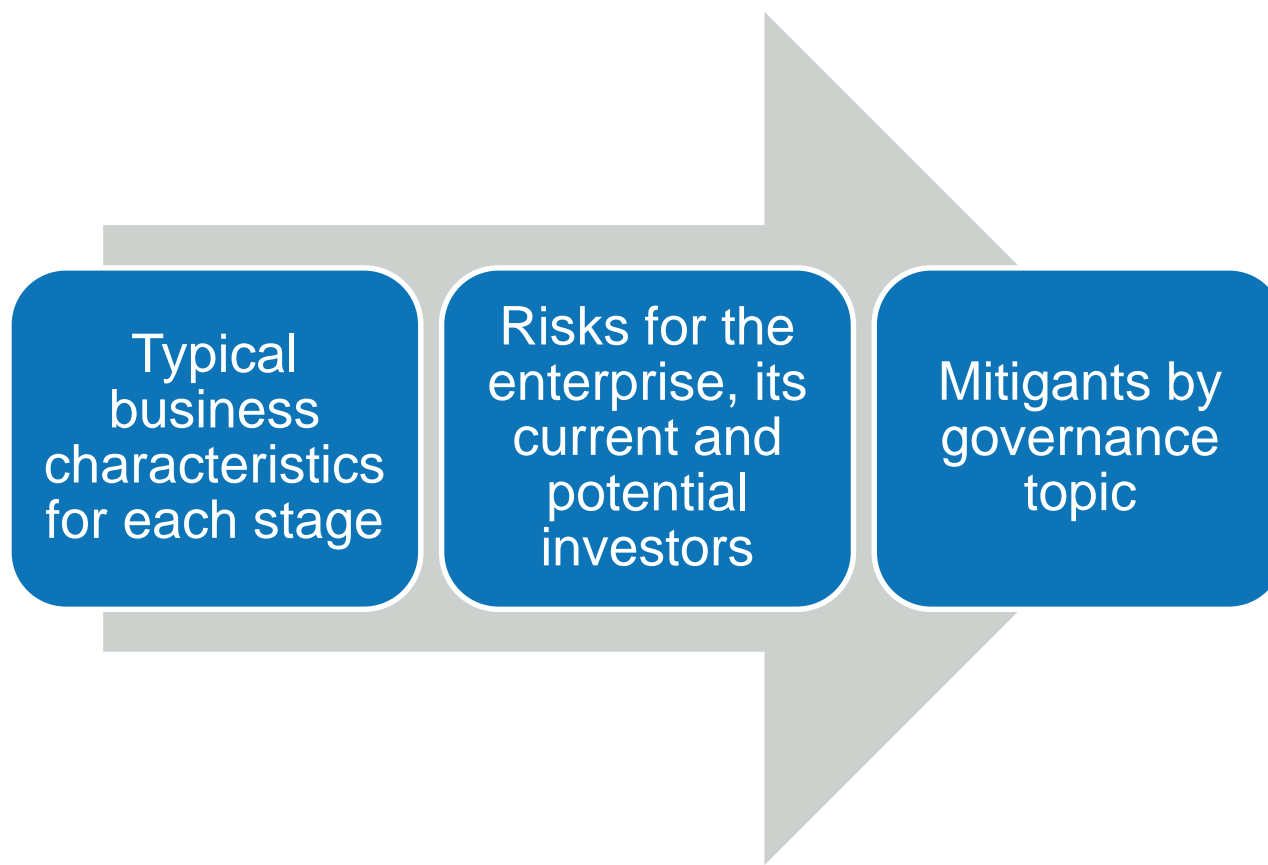
“Good governance is when the business can run itself.”

IFC MENA Client

Evolution of SME Governance



SME GOVERNANCE TOOL DEVELOPMENT



Typical Business Characteristics

	Stage 1 START-UP
Focus of the enterprise	Developing products, testing the market
Culture and Commitment to Good Gov. (Policies, processes and org.structure)	Small multitasking team High degree of informality Few systems, established "on the go"
Decision Making and Strategic Oversight	Highly centralized decision making by the founder(s) Autocratic leadership style
Risk Governance and Internal Controls (checks and balances)	Founders are fully involved in operations—limited need for checks and balances
Disclosure and Transparency	Everyone knows everything
Ownership	Single owner or couple of individuals Founders personally control every aspect of business

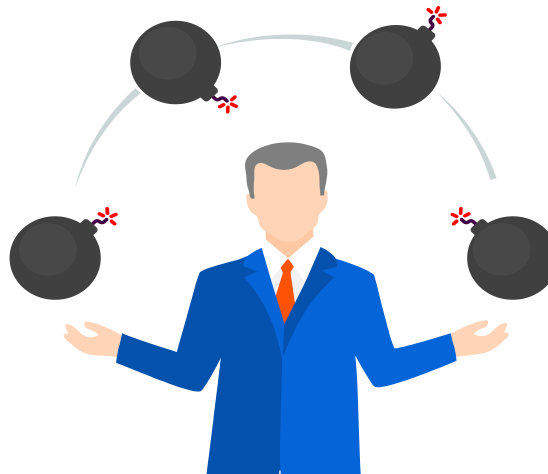


1. START UP KEY RISKS AND MITIGANTS

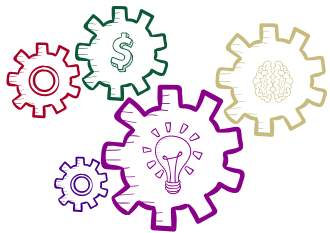


Confusion between business and personal finances

Insular leadership



Lack of clarity on the roles, authorities and responsibilities



- Incorporating external advice
- Shift towards more inclusive management
- implementing and cost-effective systems for cash flow management, identifying core functions needed for further growth
- ...

STAGE TRANSITION



Focus shifts from product/service development to sales and building customer base

Typical Business Characteristics

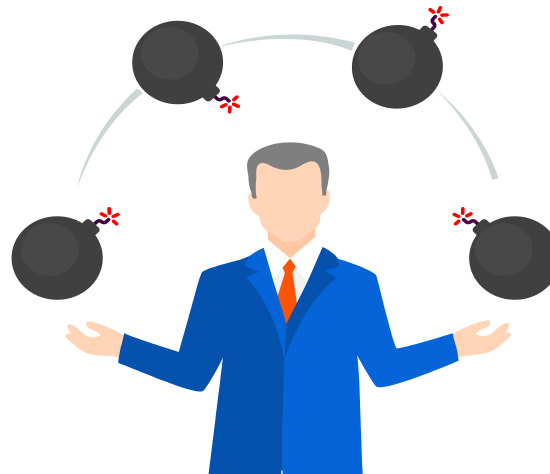
	Stage 1 START-UP	Stage 2 ACTIVE GROWTH
Focus of the enterprise	Developing products, testing the market	Sales and growth, increasing variety of products, creating solid client base
Culture and Commitment to Good Gov. (Policies, processes and org.structure)	Small multitasking team High degree of informality Few systems, established “on the go”	Team is growing—distinct functions and organizational structure start emerging Simple systems to enable functions to collaborate
Decision Making and Strategic Oversight	Highly centralized decision making by the founder(s) Autocratic leadership style	Emergence of delegation to management Consultative leadership style—largely autocratic but with input from key managers and advisers
Risk Governance and Internal Controls (checks and balances)	Founders are fully involved in operations—limited need for checks and balances	Introducing internal controls to support delegation of authority
Disclosure and Transparency	Everyone knows everything	Silos—good within, but challenging between silos Basic external information shared on products offered
Ownership	Single owner or couple of individuals Founders personally control every aspect of business	New minority shareholders possible (internal or related) Founders remain dominant and fully engaged Increasing number of family members becoming involved in operations



2. ACTIVE GROWTH KEY RISKS AND MITIGANTS

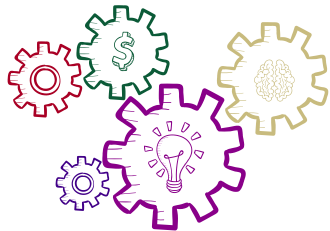
Vaguely defined policies, reporting lines, authorities, and responsibilities

Mismatch between available staff and functions needed for growth



Need for flexibility conflicts with growing demand for business focus

Excessive concentration of power in the founder/CEO



- Developing basic organizational structure and processes.
- Start defining processes for operational and strategic decision making.
- Effective delegation
- Internal controls to promote accountability and secure assets.
- ...

STAGE TRANSITION



While the company has grown dramatically, the internal structure, policies, and practices have remained similar to what they were when the company was small. Increasing business size and complexity drives the owner to realize that he or she can no longer *directly* control and manage it all.

Typical Business Characteristics

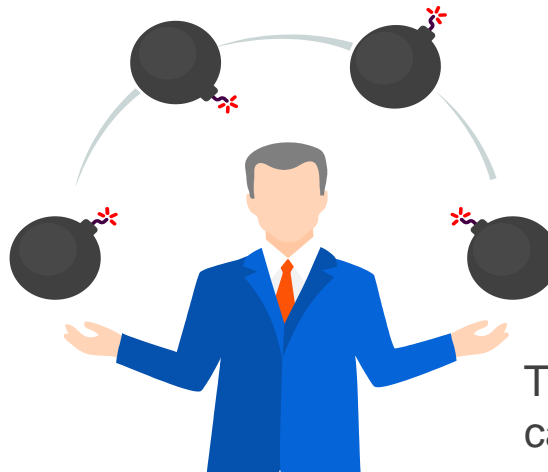
	Stage 1 START-UP	Stage 2 ACTIVE GROWTH	Stage 3 ORGANIZATIONAL DEVELOPMENT
Focus of the enterprise	Developing products, testing the market	Sales and growth, increasing variety of products, creating solid client base	Optimizing own structure/processes after growth
Culture and Commitment to Good Gov. (Policies, processes and org.structure)	Small multitasking team High degree of informality Few systems, established “on the go”	Team is growing—distinct functions and organizational structure start emerging Simple systems to enable functions to collaborate	Increased professionalization of functions Formalizing organizational structure, policies, and procedures
Decision Making and Strategic Oversight	Highly centralized decision making by the founder(s) Autocratic leadership style	Emergence of delegation to management Consultative leadership style—largely autocratic but with input from key managers and advisers	Professional managers are hired Decentralization of authority through division/functional management Collaborative management style
Risk Governance and Internal Controls (checks and balances)	Founders are fully involved in operations—limited need for checks and balances	Introducing internal controls to support delegation of authority	Detailing authorities and accountability Systems are formalized and automated Developing practices to control main operational risks
Disclosure and Transparency	Everyone knows everything	Silos—good within, but challenging between silos Basic external information shared on products offered	Internally: improving cross-divisional/ functional information sharing Enhanced external business-related information
Ownership	Single owner or couple of individuals Founders personally control every aspect of business	New minority shareholders possible (internal or related) Founders remain dominant and fully engaged Increasing number of family members becoming involved in operations	New minority shareholders possible (internal or related) New investors informally influence strategy but are not directly involved in operations

3. ORGANIZATIONAL DEVELOPMENT KEY RISKS AND MITIGANTS



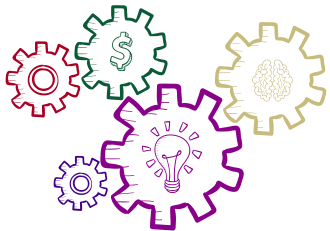
Ongoing organizational, staff, and operational changes affect employee morale and motivation

Mismatch between company size and complexity, and its internal structures, policies and processes



Growing need for discipline and good administration has to be balanced against the need to maintain entrepreneurial spirit

The focus on internal development can lead to a slowdown in growth



- Practices to support good administration, documentation of processes and procedures, professional management, structured and collaborative decision making.
- Formalized advisory board may support the owner/CEO on strategic issues.
- Formalized system of internal checks and balances, basic internal audit function.
- ...

STAGE TRANSITION



Change in the structure of ownership, or in relationship between the shareholders and the company. For example:

- Need for external capital or expertise leads to external investors such as a PE Fund
- The founder is getting out of the active management

Shareowners will require effective governance mechanisms for the control and direction of the company.

Evolution of SME Governance

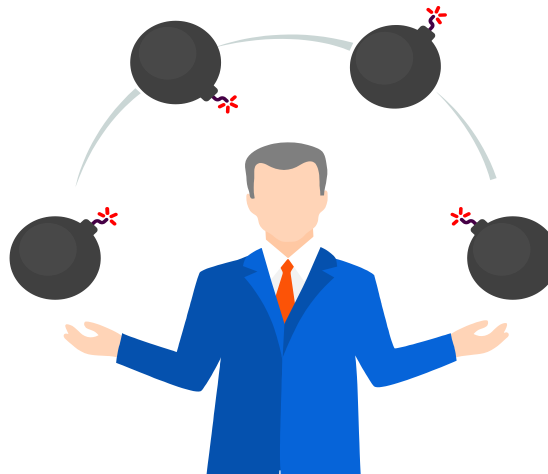
	Stage 1 START-UP	Stage 2 ACTIVE GROWTH	Stage 3 ORGANIZATIONAL DEVELOPMENT	Stage 4 BUSINESS EXPANSION
Focus of the enterprise	Developing products, testing the market	Sales and growth, increasing variety of products, creating solid client base	Optimizing own structure/processes after growth	Further growth, supported by improved internal organization and processes
Culture and Commitment to Good Gov. (Policies, processes and org.structure)	Small multitasking team High degree of informality Few systems, established "on the go"	Team is growing—distinct functions and organizational structure start emerging Simple systems to enable functions to collaborate	Increased professionalization of functions Formalizing organizational structure, policies, and procedures	Continuation of trends started in Stage 3
Decision Making and Strategic Oversight	Highly centralized decision making by the founder(s) Autocratic leadership style	Emergence of delegation to management Consultative leadership style—largely autocratic but with input from key managers and advisers	Professional managers are hired Decentralization of authority through division/functional management Collaborative management style	Separation of strategic and operational decision making Institutional decision-making style, based on defined organizational structure, roles, and procedures
Risk Governance and Internal Controls (checks and balances)	Founders are fully involved in operations—limited need for checks and balances	Introducing internal controls to support delegation of authority	Detailing authorities and accountability Systems are formalized and automated Developing practices to control main operational risks	Focus on proactive and strategic risk management, shareholder assurance
Disclosure and Transparency	Everyone knows everything	Silos—good within, but challenging between silos Basic external information shared on products offered	Internally: improving cross-divisional/ functional information sharing Enhanced external business-related information	Optimizing communication between management, board, and shareholders
Ownership	Single owner or couple of individuals Founders personally control every aspect of business	New minority shareholders possible (internal or related) Founders remain dominant and fully engaged Increasing number of family members becoming involved in operations	New minority shareholders possible (internal or related) New investors informally influence strategy but are not directly involved in operations	Common options: a. External Investors (i.e. PE) b. Growing family ownership/generational change c. Go Public (IPO) Investors require tools for control and direction of the company



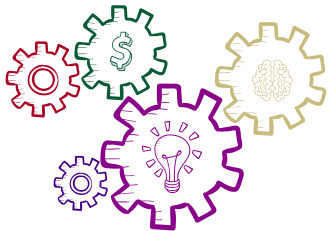
4. BUSINESS EXPANSION KEY RISKS AND MITIGANTS

Growing bureaucracy reduces entrepreneurial drive, innovation and creativity

Unequal treatment of shareholders.
Shareholders and shareholder – management conflicts.



For family business – blurred lines between ownership and management. Unclear succession.



- Building “traditional” corporate governance institutions and policies (such as a board of directors) to balance interests of different shareholders, bring in new expertise and perspective, and to support development of long-term strategy.
- Risk-based internal controls and reliable financial and nonfinancial reporting to assure non-managing investors.
- ...

SME Governance Matrix

	Stage 1 START-UP	Stage 2 ACTIVE GROWTH	Stage 3 ORGANIZATIONAL DEVELOPMENT	Stage 4 BUSINESS EXPANSION
Culture and commitment to good governance	Core functions identified Articles of association adopted	Core positions filled Org. chart and statement of business principles	Governance champion TORs for key positions Core processes documented A calendar of corporate events	Governance action plan Company secretary function Governance provisions incorporated in the articles of association and bylaws
Decision making and strategic oversight	Consultations with executives and informal advisors Authority limits defined	Formal ext advisors Delegation of authority ExCo or similar created Biz Continuity for CEO and key staff Staffing priorities clear	Advisory Board Executive committee formalized HR policies to attract, retain, and motivate staff Succession planning framework	A board of directors Board procedures ensure effective meetings and input from all directors Succession-planning policy has been approved by the board
Risk governance and internal controls	Basic bookkeeping, cash flow management, tax functions Cash sources, bank accounts are separate from the founder's Basic regulatory compliance	Basic principles of business conduct Basic business risks identified Processes for tax payments, records, and filing Cash mngmt control	Code of ethics and business conduct Objectives, strategic planning, budget, KPIs, and clear accountabilities A basic internal audit function Monitoring and mitigating risks A professional CFO Business units with clear authority, reporting lines, and guidelines	Effective internal controls systems (e.g. based on COSO) Independent external auditors Timely and secure recording and reporting for sales and accounts
Disclosure and Transparency	Basic financial accounts prepared The same financial information and data are used for all purposes	Monthly bank account reconciliation to founders Stakeholders receive consistent financial and nonfinancial info The public profile of the enterprise developed	Financial statements in accordance with national accounting standards Point person for information sharing Key decisions communicated to staff Basic performance reports are presented to external advisers Nonfinancial information to the public	Fin. reporting in IFRS or U.S. GAAP (for foreign investors) External Audit Periodic reports to investors An annual report (or equivalent) Information on request to shareholders
Ownership	Clear roles and responsibilities of the founder(s) and family Shareholder dispute resolution mechanism	Non-family and family issues are differentiated Awareness of family succession planning Annual shareholders' meetings	Differentiating roles of the founder(s), family members, and managers Career paths for non-family executives Family succession plan Annual shareholders' meetings include discussions of key decisions made, dividends, and plans	Policies and mechanisms to regulate family members' ownership, employment, etc. Shareholders are regularly updated on key developments Mechanism for resolving governance-related disputes

TRUST