

UNIVERSITY OF NAIROBI
Seed Enterprise Management Institute
(SEMI)

Seed Business Management Course

CORPORATE GOVERNANCE

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Introduction

- ❖ The basic purpose of all commercial companies is to preserve and enhance the investment which created them, not just in the short term but in perpetuity.

- ❖ Good governance practices can increase the chances of wealth creation in the short term, but they can make a much greater difference in the longer term, partly through creating confidence in those on whom the company depends.

- ❖ Competitive pressures are growing, community expectations are increasing, and the standards required for success are rising.
- ❖ Good corporate governance can make a great contribution to success, bad governance makes failure more likely.
- ❖ Better-governed companies have less management problems.
- ❖ It is therefore in the interests of **all enterprises** to consider whether they can improve their system of governance.

- ❖ Leading your enterprises to thrive in a competitive world, very often with resource constraints is the enormous challenge you face.
- ❖ Therefore, you have to be competent in strategic planning and internal control.
- ❖ Corporate governance addresses both of these areas.

Governance and “Good” Governance

- ❖ Governance is not the same as Good Governance.
- ❖ **“Governance” is:** – “the processes and structures that an organization uses to direct and manage its general operations and program activities”
- ❖ **Good Governance:** – Achieving desired results and achieving them in the right way.

❖ The understanding and implementation of a good corporate governance framework presents SMEs with a structured path to:

- Better management practices,
- Effective oversight and control mechanisms which lead to opportunities for growth,
- Financing,
- Exit strategies,
- Improved performance,
- Effective management of relationships among stakeholders, defining their roles and rights.

- ❖ Good governance is underpinned by the principles of openness, integrity, and accountability.
- ❖ It is about ensuring that those responsible for directing an organization ensure that resources are exclusively devoted to pursuing its defined goals, and account appropriately to shareholders and other stakeholders, who in turn can hold them accountable.
- ❖ Its objective is to promote strong, viable and competitive companies through efficient functioning of the interplay among different stakeholders.

- ❖ Good corporate governance goes beyond compliance with legislative and regulatory requirements.
- ❖ It is about embedding the principles of accountability throughout the organization and creating a mechanism of checks and balances.

CG Pillars for SMEs

1. Adopt a formal corporate governance framework outlining the roles of the key bodies such as partners, shareholders, board of directors and management.
 - Clarity on how the company is to be governed.
 - Partners' and shareholders' rights and obligations should be clearly set out.
 - Formal delegation of authority.

2. Conduct a succession planning process.

- Deliberate development and facilitation of change leadership in a progressive, planned and non-disruptive manner.
- Assure various stakeholders on the longevity of the company, preserving its reputation and brand value.
- Should be embedded in the company's strategic planning, addressing both managerial succession and ownership succession.
- Put in place a rigorous succession planning methodology providing for both planned and emergency scenarios.

3. Establish a timely, open and transparent flow of information with shareholders.

- Establish clear lines of communication with shareholders ensuring timely and accurate disclosure of pertinent information.
- Initiate an effective engagement mechanism to gauge the views of shareholders (e.g. AGM).

4. Endeavor to set up a formal Board of Directors to accompany the growth of the company.

- A board formalizes the decision making process within the company, adds a layer of checks and balances, and facilitates better strategic thinking.
- Smaller companies may wish to set up an “advisory” board with no formal decision making powers but which offers its expertise and networks to guide and support the business.

- For entrepreneurs looking for strategic advice, the appointment of 'outside' or independent non-executive directors can be a fast-track to commercial wisdom.
- Two to three people is a sufficient size for an advisory board for a small business.
- As the business grows, a formal board of directors should be established with formal procedures.
- Consider appointing independent board members.
- New directors should undergo a tailored induction program

5. Develop a clear mandate for the Board of Directors to oversee the overall performance of the business.
 - Building an effective board takes time and patience and requires the entrepreneur/founder to have a clear vision of what to expect from the board and how it can add value.
 - The board charter should have a clear definition of the role of the board.
 - The board should meet as frequently as necessary for the discharge of its obligations and the agenda topics should include all items it is expected to discuss.

- The board should provide entrepreneurial leadership to the company within a framework of prudent and effective controls which enables risk to be assessed and managed.
- Boards should undergo regular performance evaluation process and regularly review the composition of the board.
- With time, consider separating the roles of the chairman and the chief executive officer.

6. Maintain credible books of accounts, which are annually audited by an external auditor.
 - Any changes in accounting policies should be disclosed and justified in the financial statements.
 - Review the effectiveness of the audit process.

7. Set up an internal control framework in place and conduct a regular review of risk.

- Regularly review the risks facing the company, particularly in the case of growth companies which are likely to be facing a new set of risks as they expand.
- Bear in mind that heightened sensitivity to risk may stifle innovation and creativity, and that risk taking is an essential element in entrepreneurship.
- Should consider establishing an internal audit function (if it is not yet established).

8. Recognize the needs of stakeholders.

- Stakeholders are understood to mean employees, customers, suppliers, creditors, regulators, the community, the environment, and generally any party enjoying relations with the enterprise.
- View yourselves (the companies) as integral parts of the community in which you operate and are committed to a sound relationship built on respect, trust, honesty and fairness.
- Formulate policies governing your company's relationship with its stakeholders.

9. Formulate a framework setting out the family's relationship with the business.

- If family members are engaged in the business, clear lines of authority and decision-making, policies on employing family members, and clarifying the separation of the family business and the business of the family should be developed.
- In later generations as the family and business get more complex, families should consider establishing a family governance institution such as a "family council".

CG for Different SMEs

❖ SMEs can be categorized as:

1. Small entities owned by single individuals. Operations may involve a few family members.
2. Larger entities employing non-family people. Owners may include a few family members or outsiders.
3. Medium sized companies with several shareholders, or unincorporated partnerships.

❖ Understand which CG practices are applicable to your case.

Category I:

- ❖ The owner has no need to consider other shareholders or non-family employees.
- ❖ But he/she will certainly have to:
 - Satisfy customers,
 - Maintain the confidence of suppliers and possibly creditors,
 - Establish a sound reputation in the community in which the enterprise operates.
 - Keep credible accounts and a simple system of internal control which enable the entrepreneur to know what is really going on in the business, and also enable the lenders to accept them as reliable.

- Keep accurate and up to date records of revenue, expenditures, debtors and creditors.
- Develop a simple, written business or strategic plan which defines the company's objectives and the chosen route for reaching them.
- Come up with a simple set of performance indicators, including a budget and a system for monitoring debtors and creditors to enable the entrepreneur to monitor whether the company is performing in accordance with the plan.
- Conduct a simple analysis of the risks facing the company and develop basic policies for managing them to assist the entrepreneur to avoid disaster.

- Submit audited financial statements (those registered as companies).
- Have some form of succession plan which should make provision for the continuance of the business if the entrepreneur dies, becomes unable to manage the business, or wishes to retire.

Category II

- This category of enterprises makes the accounting and internal control process more complex and more important.
- The entrepreneur may no longer be able to watch over all the operations and may need formal systems to check on activities he cannot supervise directly.
- The business plan is also more likely to be more detailed and it may need to span a longer time horizon, perhaps three, or even five, years. It will also be more important to review it annually.

- These companies need more performance indicators and the process of collecting the relevant data and presenting it in a usable form will require closer attention. Both financial and non-financial performance indicators will be found to be valuable.
- A formal process of evaluating the risks facing the organization may be worth the while. It is best to evaluate risks according to the likelihood of occurrence and the consequences if they do occur.
- Written policies for managing the most serious of the risks are likely to help avoid disaster.

- If several family members are taking an active role in the company, the succession plan will assume far greater importance and will have to be understood and agreed by the up-coming generation.
- Simple policies covering remuneration and other human relations issues such as incentives, discipline and dismissal.
- Managers or executives other than the entrepreneur will have to make some decisions and simple policies to guide decision making will be necessary so that the company is perceived to be consistent and reliable.

- If capital has been contributed by anyone other than the original entrepreneur, a system must be introduced which allows all concerned to understand the company's financial situation and feel comfortable that they are being treated fairly.
- Boards of advisers can be appointed by those who control enterprises and asked to provide advice on selected matters.

Category III

- Some of the companies in this category may be seeking, or have sought, the investment and assistance of venture capitalists and, as a consequence, have accepted additional disciplines over their operations.
- The entrepreneur will no longer be able to do as he pleases with his company; the law requires him to act in the interests of the company.
- These companies will need a more formalized and robust corporate governance framework.

Conclusion

- ❖ Understanding and building a foundation of “**GOOD**” corporate governance within your Seed Companies can only contribute to better business practices.
- ❖ SMEs who start small and build their corporate governance framework with the growth of the business will achieve greater success long-term.

THANK YOU