A Guide to Corporate Governance in Small and Medium Enterprises

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The information contained in this Guide is of a general nature and not intended to address the circumstances of any specific individual or entity, whose culture, nature, size and other circumstances should be considered when governance measures are introduced. Appropriate professional advice may be beneficial when such measures are being introduced. The Institute of Chartered Accountants of Sri Lanka shall not be liable for loss or damage, whether direct, indirect, consequential or otherwise, arising from anything done or not done based on this Guide.

1 Introduction

Small & Medium Enterprises (SMEs) are the backbone of the country's economy and the aspiring Corporate of the future. However, many face significant obstacles to growth in terms of access to finance, markets and talent pools, due to lack of stakeholder confidence. Sound Corporate Governance supports long term sustainability of SMEs and builds stakeholder confidence, facilitating their transition from SME to Corporate. Accordingly, the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) has developed guidance for SMEs on application of sound Corporate Governance principles to support the evolution of SMEs to the next generation of Corporates.

1.1 What is Corporate Governance and what are its benefits?

Corporate Governance is essentially about effective leadership. It can be used as a mechanism to create relevant processes, systems and controls and encourage appropriate behaviours to ensure long term sustainability of an Organisation. Importantly, it helps to ensure decisions are made in the best interests of the Organisation while balancing stakeholder interests.

Improved Corporate Governance has the potential to significantly boost productivity, growth and job creation. The benefits of governance can include, among other things, the following:

- Improved leadership, decision-making and strategic vision;
- Reduced vulnerability, with improved mechanisms to monitor and manage risks; and
- The confidence of internal and external stakeholders, enabling access to markets, finance, talent pools and potential business partners, who need assurance that the Organisation is run in a responsible manner to safeguard their interests.

1.2 What are the critical success factors for sound Corporate Governance in an SME?

- Leadership - key-decision makers (i.e. shareholders or owners) must be convinced of the benefits of implementing a governance framework and provide leadership for its implementation as their commitment is essential in order to make governance work.
- Relevance - the governance framework should be implemented taking into consideration the scale and complexity of the business, as Corporate Governance is not an end in itself, but rather a means of adding value.
- Communication – Organisation structures, management approaches, policies and other guidance must be articulated and reinforced through regular communication.
- Systematization – applicable across the Organisation in a consistent manner

1.3 How does the Code of Best Practice on Corporate Governance apply to SMEs?

The Code of Best Practice on Corporate Governance 2017, issued by CA Sri Lanka is a voluntary code for Corporate Governance in Sri Lanka. It consists of principles (i.e. the underlying outcomes to be achieved). The extent to which these governance principles apply to a specific business will differ from entity to entity. Since SMEs vary significantly in both nature and size, the extent to which governance principles applies to SMEs and their resultant implementation, is sometimes uncertain.

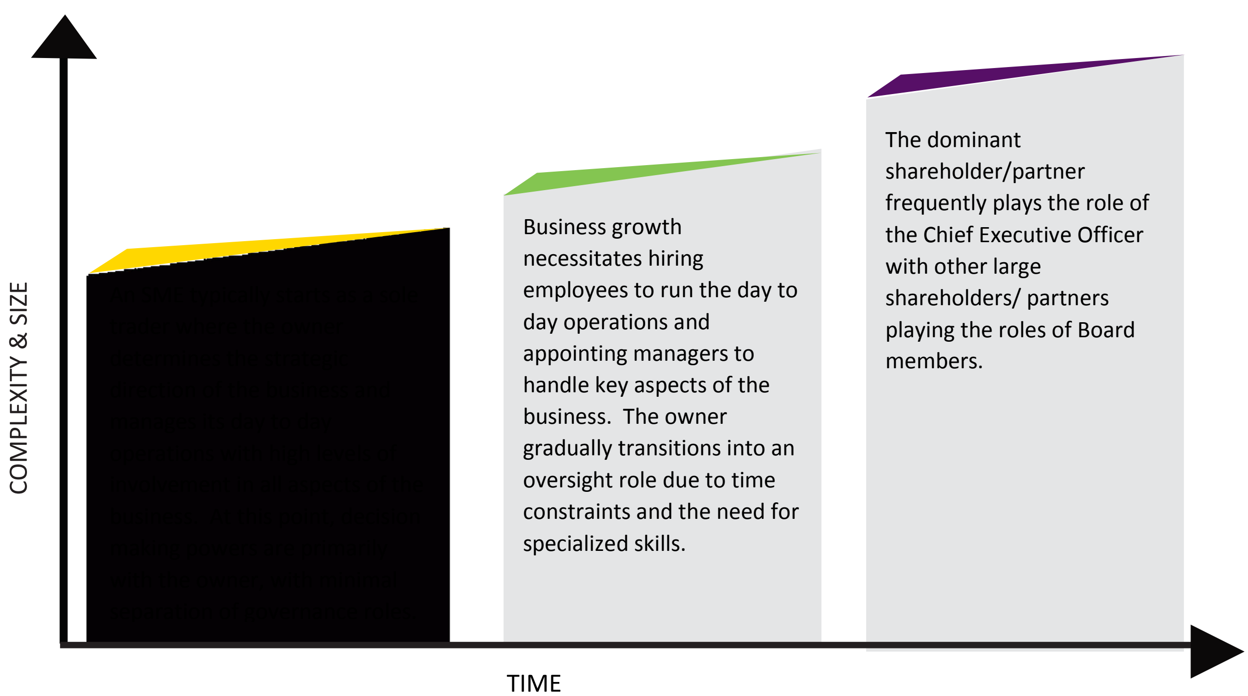
1.4 Who are the key players in a governance structure?

A typical governance structure of an incorporated company consists of the three levels of authority given below, together with their roles.

- **Shareholders**: Shareholders are the owners of the business and exercise their powers at a meeting of the shareholders or by way of a resolution in lieu of a meeting. Powers reserved for shareholders are stated in the Articles of Association and their rights and obligations are set out in the Companies Act.
- **Board of Directors**: The Board of Directors governs, oversees and directs the Organisation. The Board delegates an appropriate level of executive power to management but remains ultimately responsible for the strategic direction of the business. As the shareholders appoint the Board, the Board is accountable to the shareholders and for oversight of management.
- **Management:** Management is responsible for managing the day to day affairs of the company in line with the vision, strategy and values of the company. This includes planning, organizing, staffing, leading, motivating, and exercising effective control over its operations.

In an SME, one or more these roles may be played by the same individual(s). Whilst these specific terms or roles may not apply to SMEs which are not incorporated as companies, it is still important to distinguish between these different governance roles during decision-making (i.e. to ensure the right hat is worn at the right time).

An effective governance framework establishes stable and effective relationships between shareholders, the Board and management (which roles may be performed by the same individual(s) in some SMEs), and other stakeholders



1.5 How can this guide be used?

The Owner/Board needs to consider the current evolutionary stage of the Organisation and adopt the most appropriate Corporate Governance measures considering the scale and complexity of the business. The level of governance required will be relative to where the Organisation fits in the SME growth spectrum and will change as the Organisation grows.

Each SME Board must use its collective judgement to determine whether the application of a principle/recommendation will be in the best interests of the Organisation, and how to best achieve the desired outcome in the context of its specific business. Reference to the text of the Code of Best Practice is desirable when making these determinations.

An Organisation, even if not required to apply a recommended practice due to its current structure or size, should elect to apply the practice as soon as practically possible, to prepare itself for growth.

The Owner/Board should use collective judgement to determine appropriate governance principles considering:

- *The nature of business, complexity and scale*
- *Level of owner involvement in day to day operations*
- *Key concerns of other stakeholders*

The single most important determinant of the appropriate governance framework is whether an Organisation is Owner Managed or Non-Owner Managed as the reliance on others can vary considerably in the different stages of an SME's existence. As the reliance on others grows, there is an increased risk of misalignment between the shareholder, the Board and management, which may lead to decreasing Organisational value. In the case of an Owner Managed SME, governance should be based on the four ethical values expressed under Section 2 with regard to stakeholders beyond shareholders, as the risk of misalignment between shareholders, the Board and management is significantly reduced. When an SME is Non-Owner Managed, more stringent governance considerations to protect owners/shareholders should be applied.

2 Application of Corporate Governance in SMEs

SMEs will reap benefit from their investments in Corporate Governance when it is approached with a mindset of building a solid foundation for creating value rather than as a mere compliance exercise. It requires mindful application of the principles to drive sustainable growth, acknowledging that an Organisation doesn't operate in a vacuum, but is an integral part of society and therefore has accountability towards current and future stakeholders.

> "The overarching objective of King IV™ is to make corporate governance more accessible and relevant to a wider range of Organisations, and to be the catalyst for a shift from a compliance-based mindset to one that sees **corporate governance as a lever for value creation**"
>
> Prof. Mervyn King, Chairman, King Committee on Corporate Governance

Ethical Leadership and Corporate Citizenship

Good governance is essentially about effective leadership based on an ethical foundation. This is characterised by the ethical values of responsibility, accountability, fairness and transparency which are applicable to all Organisations, irrespective of nature and size. Ultimate accountability rests with the Owner/Board and therefore responsible leaders direct strategies and operations with a view to achieving sustainable economic, social and environmental progress.

There is increasing focus on the Board's role to ensure that Organisations are responsible corporate citizens, accountable for their impact on society and the environment in addition to the traditional focus on financial performance. Consequently, a growing number of companies adopt a ''triple bottom line'' approach to Corporate Governance to comply with other stakeholder concerns on environmental, social and governance aspects. SMEs stand to gain significant competitive advantages from adopting the triple bottom line approach to governance due to the increasing pressure for sustainable sourcing and transparency across supply chains.

It is important to understand that "Stakeholders" are not only shareholders but include any other group affected by or affecting the Organisation's operations, such as employees, customers, suppliers, creditors and the community in which the Organisation operates. All SMEs (regardless of size, complexity and nature) will therefore have stakeholders whose interests and expectations it should consider when making strategic decisions.

Applying the Guidance-Ideal outcomes

- Ethical culture – promotes ethical behaviour among members of the Organisation through shared values.
- Good performance – Organisations with sound Corporate Governance are more likely to be more objective in decision making, manage risks effectively, recognize stakeholder concerns and address them in a proactive manner, outperforming peers.
- Effective control – Clearly established governance structures pave the way for effective delegation and accountability within an organization, facilitating effective control over the affairs of the organization.
- Legitimacy – good corporate citizenship, which considers the legitimate interests of stakeholders throughout the value creation process, which will determine the trust and confidence placed in it by society.

Preparing a Code of Conduct can be a meaningful exercise to identify what the Organisation's values are and what its business, staff, management and Directors should adhere to. It is recommended that every SME, irrespective of nature and size, should develop a Code of Conduct to serve as its business's ethical compass. In addition, every entity should have a strategy that is ethically sound. Industry codes of conduct can serve as a good starting point when an Organisation develops its own code.

Related Corporate Governance Principles

Principle A.1	Every public company should be headed by an effective Board, which should direct, lead and control the Company.
Principle A.1.2	The Board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. In performing its role, the Board should be responsible for matters including ensuring compliance with laws, regulations and ethical standards.

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3 Strategy

A challenge faced by most SMEs is the development of strategy, especially in an Owner-Managed SME. A fundamental step for success is the development of a viable strategic vision and plan, alongside an identification of the Organisation's core competencies and business drivers.

Strategic thinking relates to what the Organisation wants to be and achieve. Strategic planning relates to how the Organisation will achieve the strategic vision; this includes preparing the required business / action plan and determining the structures and processes required.

A key reason for business failure is the lack of proper strategic thinking and planning at the outset. If done properly, strategic planning enables the owner to consider:

- what he/she wants to be/do with the business
- the resources required to achieve the strategic vision;
- the market he/she wishes to operate in and how it works;
- ultimately, whether or not he/she has a viable business; and
- eventually, changes to the plan to make the business viable (when it is not, but can be made viable).

Clear strategic thought and the right attitudes are key to a successful business. Every Corporate started out small; its ability to visualize goals and effectively plan actions to reach them will have contributed significantly to its success.

- *A business plan is a living document that must be aligned to the strategic vision/objectives of the Organisation and must be reviewed continuously and updated as the Organisation grows.*
- *Strategy development should address the continuously changing business environment and market conditions impacting on the Organisation.*

Applying the Guidance-Ideal outcomes

- Strategy that is aligned with the purpose and values of the Organisation and bears in mind the legitimate interests and expectations of stakeholders, resulting in business continuity.
- Long-term strategy which takes into account risk indicators, the external environment and changing market conditions, resulting in sustainable outcomes.

Firstly, the strategy must be simple and understandable (in other words, clear and precise). Secondly, when the strategy is being agreed, the Board must understand what the Organisation's specific core competencies/driving forces are, to ensure availability of the resources required and an appropriate structure for the Organisation.

The Board must ensure the strategy followed provides for long-term sustainability of the business; it is accountable for the positive and negative consequences that may impact on the community it operates within.

Governance role players must be aligned in ensuring the Organisation's business activities are in keeping with its strategy.

Related Corporate Governance Principles

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Principle1.2 In performing its role, the Board should be responsible for matters including ensuring the formulation and implementation of a sound business strategy.

4 Structures

4.1 Board Composition

The composition of any Board of Directors and the skills and experience of Directors are important determinants of the quality and effectiveness of Board decisions. This guidance suggests the majority of Directors on a Board should ideally be non-executive (whether independent or not), to bring a balance of power, independence and objectivity. In most SMEs roles overlap, with decision-making powers concentrated among a few people; this makes objective and independent views important.

In the event that the SME finds it difficult to have more than one independent non-executive director, it may consider appointing an independent Chairman.

Applying the Guidance-Ideal outcomes

- Independence and balance of power within the Board, enhancing the quality, effectiveness and objectivity of decisions.
- A clearly understood appointment process directed at appointment of Directors with relevant knowledge, skills, experience and capacity.
- Appointment of suitable individuals who share similar values as the Board to senior management positions, ensuring a healthy relationship between management and Board.
- Clearly defined roles and delegation of authority, minimizing possible conflicts between the Board and management.
- Transparency in the appointment process, to gain the confidence and support of all stakeholders.

The need for a formalized board appointment process is greater when the owners and Directors are different. SMEs should consider the backgrounds of Directors carefully before appointment and formalize their terms of appointment appropriately.

- *Ensure suitable agreements are in place when appointing directors.*
- *Appoint directors with relevant skills, experience and knowledge*
- *Adopt an adequate board appointment process*
- *Seek professional external input when considering major decisions, specially if non- executive directors do not have the relevant skills*

4.2 Appointment of Chairman and CEO

Where the SMEs circumstances make appointment of a Chairman appropriate**,** he / she should have strong leadership skills to provide direction and ensure effective functioning of the Board. He / she should ideally be engaged in an independent non-executive capacity; if this is difficult a person trusted by the major shareholder, and not involved in day to day business operations, should play the role. The Chairman's role and responsibilities should be clearly defined, and his performance assessed annually.

The CEO, who must be capable of handling his responsibilities, is ultimately responsible for all management functions. Where the Board appoints a CEO, performance criteria should be established to hold management accountable for decisions and actions delegated to them.

Succession planning has a direct impact on business continuity and is critical in ensuring businesses survive beyond the generation of the founding entrepreneur. If the objective is to pass on the business to the next generation, appropriate measures should be taken to provide necessary training to younger family members. Succession planning should cover contingency plans to address the exit of key management personnel.

Related Corporate Governance Principles

Principle A.2	There should be a clear division of responsibilities at the head of the Company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision.
Principle A.5.1	It is preferable for the Board to have a balance of Executive and Non-Executive Directors such that no individual or small group of individuals can dominate the Board's decision-taking.
Principle A.7	There should be a formal and transparent procedure for the appointment of new Directors to the Board.
Principle A.11	The Board should be required, at least annually, to assess the performance of the CEO.

4.3 Board Support Structures

4.3.1 Board Committees

The Board can delegate oversight of specific areas to Board sub-committees, freeing Board time for matters of strategic importance. The Board has authority to establish Board Committees as required, and in appropriate situations, sub-committees may be formed covering one or more of these areas- more commonly audit and risk, but possibly nomination, remuneration and related party transactions also. Terms of reference should be developed for any committee formed and must be subject to regular review.

Where committees are not formed, the Board should allocate sufficient time to address the relevant areas of oversight.

Applying the Guidance-Ideal outcomes

- More effective use of Board time, through the creation of sub-committees to focus on specific governance areas.

4.3.2 Audit Committee

SMEs should consider the functions of an Audit Committee and be satisfied that, in the absence of one, the responsibilities under Principle D.3.2 of the Code of Best Practice on Corporate Governance (summarized alongside) are kept carefully in mind.

Applying the Guidance-Ideal outcomes

- Appropriate oversight over internal and external audit to effectively identify, monitor and manage identified risks.
- Monitor financial reporting, ensuring the reliability and accuracy of such information.

The appointment of external auditors is only required for SMEs incorporated as companies. It is yet recommended they, regardless of size, consider having internal and external assurance to monitor business operations and address identified risks.

Principle D.3.2

- Review the scope, results and effectiveness of the audit
- Ensure independence and objectivity of auditors

- If the SME is unable to appoint three Non-Executive Directors to the Audit/Risk Committee, at least the Chairman of the Committee should be an Independent Non-Executive Director.

Related Corporate Governance Principles

Principle D.3.1 The Board should establish an audit committee exclusively of non-executive Directors with a minimum of three non-executive Directors of whom at least two should be independent. If there are more non-executive Directors, the majority should be independent. The Committee should be chaired by an independent nonexecutive Director. The Board should satisfy itself that at least one member of the audit committee has recent and relevant experience in financial reporting and control.

Principle D.3.2 The audit committee should have a written Terms of Reference, dealing clearly with its authority and duties.

Schedule F Audit Committee Charter

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4.4 Company Secretary

A Company Secretary provides guidance to the Board on the discharge of its responsibilities and ensures Board procedures are carried out complying with all relevant requirements. While it is mandatory for SMEs incorporated as companies to appoint a Secretary, this should be considered by all SMEs. This can involve employing a qualified individual or outsourcing the function to an entity providing company secretarial services.

Efficient minute-taking and timely distribution of minutes of relevant meetings may be needed even where there is no Company Secretary.

The critical functions of the Company Secretary include, inter alia, the following:

- Providing guidance to Directors collectively and individually on their duties, responsibilities and powers;
- Monitoring statutory developments that affect the Organisation and ensuring the Board is kept informed of them; and
- Taking accurate and complete minutes of meetings and circulating these promptly

Applying the Guidance-Ideal outcomes

- Effective functioning of the Board with the support of a Company Secretary, who will ensure the Organisation complies with statutory requirements and adopts best practice in governance.

Related Corporate Governance Principles

Principle A.1.4	All Directors should have access to the advice and services of the Company Secretary, who is responsible to the Board in ensuring that Board procedures are followed, and that applicable rules and regulations are complied with.
Schedule G	Role of the Company Secretary

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4.5 Board Evaluation and Training

Board evaluation/assessment in any entity helps identify areas requiring attention to improve performance of individual Directors and the Board. Assessments are ideally conducted annually for those in key roles, including the Chairman, Directors and the CEO, as well as the Board and each sub-committee. Performance assessments are particularly important in Non-Owner Managed SMEs to ensure those in decision-making roles are performing as desired.

New Directors in any entity should be given an induction, enabling familiarization with the Organisation's operations, environment and other relevant issues. Directors should have ongoing training to ensure they have the relevant skills and knowledge to perform their roles and are abreast of changes in the operating environment.

- *As annual independent assessments may be costly, SMEs could consider conducting internal evaluations or self-assessments by Directors.*
- *If assessments are done internally, Independent evaluations should be considered every 3 years or so.*

Applying the Guidance-Ideal outcomes

- Improved decision making and overall management of the business supported by a skilled and knowledgeable Board.
- Effective Board performance through the identification of areas requiring improvement and continuous training.

Related Corporate Governance Principles

Principle A.1.8	Every Director should receive appropriate training when first appointed to the Board of a company, and subsequently as necessary. Training curricula should encompass both general aspects of directorship and matters specific to the particular industry/company concerned.
Principle A.9.1	The Board should have in place a formal and rigorous process for annually reviewing the performance of the Board and its Committees and should address any matters that may arise from such review, in the discharge of its key responsibilities as set out in A.1.2.
Schedule B	Board Performance Evaluation Checklist

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4.6 Remuneration

Organisations should formulate remuneration policies for transparency and consistency in remuneration, covering Non-executive Directors also. A remuneration policy which takes note of market trends and the Organisation's aspirations for long-term value creation, will enable the company to attract and retain the right individuals. Non-executive Directors' remuneration must not be directly linked to the Organisation's performance, to maintain their independence and objectivity.

Applying the Guidance-Ideal outcomes

Transparency and fairness in remuneration, through:

- implementation of remuneration policies and procedures;
- ensuring remuneration is linked to individual performance; and
- disclosing Directors' remuneration to stakeholders.

Related Corporate Governance Principles

Principle B.1	Companies should establish a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual Directors.
Principle B.2	Levels of remuneration of both Executive and Non- executive Directors should be sufficient to attract and retain the Directors needed to run the Company successfully.
Principle B.3	The Company's Annual Report should contain a Statement of Remuneration Policy and details of remuneration of the Board as a whole.

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5.0 Responsibilities

5.1 Role of the Board

A Board Charter or similar framework should be developed to formalize the Board's composition, role and procedures. The Board should act in the best interests of the Organisation, avoid conflicts of interest and exercise objective judgement in making decisions. The Board is responsible for setting strategy, implementing a sound Corporate Governance framework and establishing effective risk management.

Applying the Guidance-Ideal outcomes

- Directors who understand and fulfill their responsibilities
- Actions that are in the best interests of the Organisation, avoid conflicts of interest and comply with legal requirements.

Related Corporate Governance Principles

Principle A.1.2	The Board's role is to provide entrepreneurial leadership of the Company within a framework of prudent and effective controls which enables risk to be assessed and managed.

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5.2 Risk Management

The Board is responsible for the effective management of risks and should provide leadership in establishing processes to identify, mitigate and manage risk exposures. Oversight of risk management can be delegated to the Audit or Risk Committee if these Committees have been formed. Ideally risk management should be a part of the daily operations of an Organisation. SMEs can document risks using frameworks such as SWOT or PEST and manage them through risk registers and regular reporting to the Board.

Applying the Guidance-Ideal outcomes

- Risks are mitigated through the implementation of an effective risk management framework which includes risk policies, systems and processes.
- Findings of the risk management processes are utilized to ensure the long-term growth and sustainability of the business.

Related Corporate Governance Principles

Principle A.1.2	The Board's role is to provide entrepreneurial leadership of the Company within a framework of prudent and effective controls which enables risk to be assessed and managed.
Principle D.2	The Board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives. The Board should have a process of risk management and a sound system of internal control to safeguard shareholders' investments and the Company's assets.
Principle D.2.1	The Board should monitor the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness, and report on that review in the annual report. The monitoring and review should cover all material controls, including financial, operational and compliance controls.

5.3 Internal Controls

Organisations should seek to establish a framework of internal controls to ensure identified risks are managed effectively. An internal audit function ensures these controls and processes are adequate and checked regularly. Relatively small organisations may not need a formal internal audit function provided the underlying functions of internal audit are carried out by the owner or an employee.

As an SME grows and decision-making powers are spread among more employees, internal audit is important in providing assurance to the owners and should be established as a formal function.

Applying the Guidance-Ideal outcomes

- Identified risks are managed through appropriate internal controls.
- The Board is assured the internal controls in place provide sound defenses.

Related Corporate Governance Principles

Principle A.1.2	The Board's role is to provide entrepreneurial leadership of the Company within a framework of prudent and effective controls which enables risk to be assessed and managed.
Principle D.2.3	Companies should have an internal audit function.
Schedule L	The Responsibilities of Directors in maintaining a sound system of Internal Control

5.4 Stakeholder Relations

Organisations should constructively engage with their stakeholders (including shareholders / investors, employees, lenders, creditors, customers, media and the community) allowing them to understand their expectations and build trust.

Organisations may at times need to report on their business and financial position (for example when applying for a loan or submitting a tender). SMEs can seek to adopt the Integrated Reporting framework when preparing such a document or an Annual Report (or similar but simpler document) conveying information on the Organisation's operations, performance, sustainability and governance among others.

Applying the Guidance-Ideal outcomes

- Nurturing strong stakeholder relations and enhancing corporate reputation.
- Providing an accurate and complete representation of the Organisation's performance to stakeholders.

Related Corporate Governance Principles

Principle A.3.1	The Chairman should conduct Board proceedings in a proper manner and ensure, inter-alia, that: the Board is in complete control of the Company's affairs and alert to its obligations to all shareholders and other stakeholders.
Principle C.1	Boards should use the AGM to communicate with shareholders and should encourage their participation.
Principle C.2	The Board should implement effective communication with shareholders.
Principle A.1.2	The Board should be responsible for matters including recognising sustainable business development in Corporate Strategy, decisions and activities and consider the need for adopting "integrated reporting".
Principle D.1.6	The Management Discussion & Analysis may be structured based on the Integrated Reporting Framework issued by International Integrated Reporting Council and "A Preparer's Guide to Integrated Corporate Reporting" and subsequent publications issued by CA Sri Lanka.

5.5 Compliance with Laws, Rules, Codes and Standards

SMEs, regardless of size and form, must comply with all relevant legislation, rules, codes and standards applicable to them and the industry in which they operate. Non-compliance can result in substantial fines, possible criminal liability or reputational damage. It is recommended that SMEs compile a list of laws applicable to them and monitor compliance with them regularly.

Applying the Guidance-Ideal outcomes

- Compliance with all applicable statutory requirements to avoid liability.
- Adherence to other industry rules, codes or standards to preserve reputation and avoid liability

Related Corporate Governance Principles

Principle A.1.2	The Board should be responsible for matters including: ensuring compliance with laws, regulations and ethical standards;
Principle D.5.	Companies must adopt a Code of Business Conduct & Ethics for Directors, Key Management Personnel and all other employees' including but not limited to: dealing with shares of the company; compliance with listing rules; bribery and corruption; confidentiality; encouraging that any illegal, fraudulent and unethical behaviour be promptly reported to those charged with governance. The company must disclose waivers of the Code for Directors, if any.

6.0 Conclusion

There is a perception that the application of Corporate Governance in SMEs is costly. In reality, all SMEs are capable of implementing sound Corporate Governance at a principle level without attracting significant additional cost. All underlying principles in the Code of Best Practice for Corporate Governance apply to SMEs, but the degree to which the practices are implemented will depend on the size and complexity of their business.

SMEs must apply each principle to their specific business circumstances and consider how they can best reach the objectives outlined in this Guide considering their specific organisational structure and maturity. The principles should not be viewed as a “tick box” list but as a flexible set of proposals aimed at increasing professionalism, effectiveness and sustainability of SMEs.

Once a decision is made regarding an appropriate governance framework, it should be implemented with discipline and consistency. The credibility of the Organisation in the eyes of its stakeholders will be affected by the manner of governance implementation. Good governance requires more than the implementation of formal rules and processes. The right attitude, which spreads the spirit of key governance principles throughout the Organisation is vitally important.

1-Introduction

1.1 Corporate Governance and its benefits

Effective leadership ensuring that decisions are made in the best interests of the Organisation while encouraging behaviour that ensures long-term sustainability.

1.2 Critical success factors

- Leadership commitment.
- Relevance to the Organisation.
- Effective communication.
- Systematic application.

1.3 Application of the Code to SME

The Code of Best Practice on Corporate Governance is voluntary, and its application may vary given the nature and size of SMEs.

1.4 Key players in a governance structure

Key players include the Board, management and shareholders; these roles may overlap in an SME.

1.5 Using this Guidance

The Board should use its collective judgement in determining the appropriate principles, considering the nature and size of business, owner involvement and stakeholder concerns.

2-Application of Corporate Governance in SMEs

Ethical leadership and corporate citizenship

Ethical values of responsibility, accountability, fairness and transparency are applicable to all organisations irrespective of nature and size.

3-Strategy

An effective strategy is key to a successful business, enabling the owner to consider resource allocation, market factors and viability among others.

4- Structures

4.1 Board composition
Ideally, the majority of the Board should be non-executive. Directors' skills and experience should be considered when making appointments.

4.2 Appointment of Chairman and CEO
The Chairman should ideally be engaged in an independent non-executive capacity and possess strong leadership skills. The CEO will be responsible for all management functions.

4.3 Board support structures
The Board can use its time more effectively by delegating oversight of specific areas to sub-committees, such as audit and risk.

4.4 Company Secretary
SMEs should consider the appointment of a Company Secretary, who provides guidance to the Board and ensures Board procedures are carried out appropriately.

4.5 Board evaluation and training
Directors should be given ongoing training enabling them to perform effectively. Board evaluation/assessment will help identify areas for improvement.

4.6 Remuneration
Remuneration policies should be formulated considering market trends and Organisation's aspirations for long-term value creation.

5- Responsibilities

5.1 Role of the Board
The Board is responsible for setting strategy, implementing a sound corporate governance framework and establishing effective risk management.

5.2 Risk management
The Board should provide leadership in establishing processes to identify, mitigate and manage risk effectively across the Organisation.

5.3 Internal controls
A framework of internal controls and an internal audit function can provide assurance to owners on the robustness and adequacy of the Organisation's processes.

5.4 Stakeholder relations
Constructive engagement with stakeholders will allow Organisations to understand their expectations and build mutually beneficial relationships.

5.5 Compliance
SMEs must comply with all relevant legislation, rules, codes and standards applicable to them and the industry in which they operate.

Conclusion

All SMEs can implement sound corporate governance at a principle level without attracting significant additional cost. SMEs should consider the specific business circumstances, structure and maturity in applying the principles to reach the objectives outlined in the Guidance.
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