

# Corporate Governance Assessment Progression Matrix for Small and Medium Enterprises

Instruction Sheet

Incoming Monthly





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## The Governance of SME Companies

Small and Medium Enterprises (SMEs) are prevalent in IFC client countries. SMEs are defined as small or medium sized companies by revenue, or size of operation, or early stage of development and growth. These companies are generally characterized as entrepreneurial, often transitioning to a corporative stage of development, and poised for growth. Founders of SMEs generally have either complete ownership or effective control of the companies and, usually, a significant role in the companies' management. The complex transition from a nimble, closely held enterprise to a more complicated corporate structure yields several difficult governance issues in addition to those faced by other companies, including: stewardship, evolution of governance structures and practices; as well as scalability, delegation and staff retention, among others. The primary focus of IFC's SME paradigm is "growth into governance" supporting companies with the ambition to scale up operations and revenues as they transition SME practices into corporate entity practices. The challenges of a growing SME are addressed in this paradigm and bolsters these ambitions.

## Using the CG Tools

Eight key Corporate Governance (CG) tools are used for analyzing the governance of potential IFC investee companies. The Instruction Sheet, Progression Matrixes, Document and Information Request Lists, and the Corporate Governance Review Report Generator have been adapted for the SME Paradigm. [Note that, depending on the client and project characteristics, the Document and Information Request List can be either the Corporate

Governance Review (CGR) Report Generator or the CG Document and Information Request List.] The Model Independent Director Definition, the "Supervision Checklist", and the explanatory note "Why Corporate Governance?" are applicable across all six paradigms, without adaptation.

**1) Instruction Sheet—SMEs.** The purpose of this Instruction Sheet is to describe each of the key CG tools, how they should be used, and who should be interviewed during either a Corporate Governance Assessment or a Corporate Governance Review. (A full description of the step-by-step process for analyzing the governance of companies is provided in the section of the website, "Applying the IFC Methodology.")

**2) Why Corporate Governance?** This note explains IFC's approach as value-added for clients. *This explanatory note should be given to the client at the earliest opportunity in the pre-appraisal.*

**3) Progression Matrix—SMEs.** The Progression Matrix relates six areas of governance (Commitment to Good CG, the Board of Directors, Control Environment, Transparency and Disclosure, Shareholders Rights and Governance of Stakeholder Engagement) to four levels of achievement. The matrix framework emphasizes the importance of ongoing improvements in the governance practices of clients, rather than trying to apply rigid and static minimum standards. The Progression Matrix allows clients to assess the governance of their own company against a simple framework. *It is urged that the Progression Matrix should be given to the client for discussion, at the earliest opportunity in the pre-appraisal.*

**4) Document and Information Request List—SMEs.** This list of questions and requests for documentation establishes the basis for the Corporate Governance Assessment (CGA) of an IFC client. The Document and Information Request List is organized along the same lines as the six areas of governance in the Progression Matrix. *For a CGA, the Document and Information Request List should be circulated to the company at least three weeks in advance of the onsite visit.* The company should identify a single officer who will be charged with responding to the Document and Information Request List by providing brief written answers of one or two paragraphs to each of the questions and delivering these to IFC prior to the onsite CGA. For the CGR, the investment officer must collect the required information from the documents or from interviews during the appraisal period. If the investment officer elects to send a specially prepared CGR information request ahead of the site visit, an amended "questions only" version of the CGR Report Generator should be sent to the client. Discussions relevant to IFC's understanding of the governance of a company will arise throughout the appraisal and diligence process. Therefore, IFC Investment staff are encouraged to edit the information requests (CGA or CGR) as necessary before sending them to the client, to avoid duplication.

**5) Corporate Governance Review Report Generator:** This document is intended for use by Investment Officers (and CG Officers, in the case of detailed reviews) in conducting a CGR; preparing the corporate governance section of an Investment Review Memorandum; responding to questions from Director at the Investment Review Meeting; and in presenting any major issues to the IFC

Board. The CGR Report Generator uses negative assertions on each area of risk, and then using questions to frame the risk issue and identify and assess relevant company practices and procedures, helps Investment Officers to determine the level to which the company mitigates the risk. The Investment Officer is required to collect information about the company and report in the Decision Book CG section which features are displayed by the client and which are not. The CGR Report Generator aids Investment Officers in preparing this CG section as it indicates the data that must be collected from the client and provides guidance on how to collect this information by interviewing individuals at or contracted by the company, or by reviewing a specific legal document.

**6) Model Independent Director Definition.**

Perhaps the most common governance recommendation is to increase the board's independence from both the management and the controlling shareholders. However, to achieve genuine board independence, it is crucial to carefully define what it means for directors to be "independent." This Model Independent Director Definition is often used during discussions with the client to clarify the assessment of the current board and its future needs.

**7) Sample CG Improvement Programs or Sample Decision Book Section (for CGRs).** Sometimes, a CGA results in the need for the client to develop and implement a Corporate Governance Improvement Program (CGIP). The CGIP should

always be tailored to the circumstances and priorities of the company. However, sample CGIPs give a good idea of what has been negotiated with clients in the past; therefore, they can be used as a reference point in the drafting process. The CGR always generates a section for the Decision Book, and sometimes this will include recommendations for improvements. This Sample CGR Decision Book Section provides a useful reference point for the investment officer's use.

**8) Supervision Checklist.** The Supervision Checklist provides a list of key issues that Investment staff should consider while supervising IFC investee companies and those companies undertaking CGIPs.

**Corporate Governance Interviewees**

To carry out a thorough a corporate governance analysis (CGA or CGR), IFC staff need to have direct discussions with people who play a variety of governance roles in the company. Following, is a list of the people who would typically be interviewed. However, companies may differ significantly in how they apportion responsibilities within the titles that they use for different positions in the company, so it is important that IFC staff meet with those who, as a practical matter, are responsible for the principal corporate governance functions, regardless of their job titles. This list might include the following however not necessarily all of them.

1. Representatives of controlling shareholders
2. Representatives of other holders of significant blocks of shares
3. Senior managers
4. Formal or informal advisors to the owners and managers of the company
5. Chair and members of the board of directors or advisory group (this may also include close acquaintances who play some informal advisory role for the SME founder), including any "independent" board members, outside members of the board of directors and the chairs of the audit and other special committees of the board (and where applicable, members of the inspection committee: the fiscal board, *commissaire*, audit commission, *comisario*, or *revisor fiscal*)
6. Chief executive officer
7. Chief financial officer (or senior accounting officer)
8. General counsel (or senior lawyer)
9. Corporate secretary
10. Chief of internal audit and internal controls
11. Chief of investor relations
12. Independent external auditors
13. Sustainability officer
14. External management consultants
15. External legal counsel
16. External accountant / auditor



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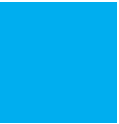
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