THE IMPORTANCE OF CORPORATE GOVERNANCE – A HANDY GUIDE FOR SMEs

The demise of BHS led to a public outcry and various initiatives to consider reform of corporate governance for public and private companies.

Many SMEs, though, wonder whether this furore has anything to with them. "Corporate governance - why bother?" Here we outline what is meant by "corporate governance"; the benefits for SMEs; and some governance tips for SMEs.

WHAT IS CORPORATE GOVERNANCE?

The name you want might not be freely available. Other businesses may already have the name that you have chosen, or something very similar. This may cause problems, particularly when you both operate in the same area of business.

Corporate governance concerns a company's system of management and control. Specifically, it covers:

- proper management including the relationships between: board members; the board and the company's shareholders; and the company and other stakeholders such as employees, creditors and customers; and
- internal controls and processes. A good corporate governance framework will lead to internal discipline, accountability and transparency.

BENEFITS OF CORPORATE GOVERNANCE FOR SMEs

Unlike large companies, for many SMEs there is no distinction between management and ownership. But that does not mean that corporate governance is irrelevant.

Even a basic corporate governance regime will bring benefits, especially if the SME has growth plans:

- **Funding** – a proper governance system improves a company's ability to obtain external funding and therefore its ability to grow. Investors will be more likely to pay a premium for shares in, and lenders more likely to fund, companies that are properly managed with good systems in place.
- **More effective management** – if there are clearly delineated roles and responsibilities within the business, and easily understood internal processes, the company's management and operations will improve. Management, shareholders and other stakeholders will also have a clear understanding of how the business operates. For owner-managed SMEs it reduces the potential for internal conflicts and lets management focus on achieving the company's growth strategy and profitability.
- **Forward planning** – a properly constituted board that holds regular meetings to discuss the company's long term strategy is vital for SMEs. Where appropriate, having one or more external non-executive board members can be of great assistance, providing additional skills and oversight and bringing balance to the views of the executives, resulting in better strategic decisions.
- **Managing risk and supporting innovation** – no business is without risk. Corporate governance does not seek to eliminate risk, or stifle innovation or creativity. Rather, by having risk management processes in place, supported by internal controls, the company can identify, monitor and mitigate its risks. This enables the

company to embark upon new initiatives confidently (be it new product development, joint ventures or other collaborations), knowing that these will be properly managed.
- **Reputation** – a company with good governance systems in place is less likely to suffer the reputational damage that can be caused when governance failures occur. Good governance in an SME can be a selling point and something worth publicising to stakeholders and the outside world.

GOVERNANCE TIPS FOR SMEs

Compliance with the full range of corporate governance regulations applicable to larger companies is of course neither compulsory nor appropriate for SMEs. Depending on the company's stage of development, here are a few governance tips for SMEs to consider:

- Ensure there is a clear and publicised definition of the roles and responsibilities of the board
- Put in place delegated authorities (e.g. authority to commit the company to expenditure, authority to sign contracts) – to whom and within what limits
- Ensure regular and properly run board meetings are held where the company strategy is discussed, budgets and finances are monitored, and progress on operations is reported.
- Evaluate whether the composition of the board is appropriate for the next stage of the company's development. Is now the time to recruit an independent non-executive director, for example?
- Implement a risk management process
- Where necessary, implement internal controls. This is especially important on the financial side (e.g. to monitor cash flow) but is also applicable to other areas of the business such as security of assets and company data.
- Develop a disaster recovery and business continuity plan.

CONCLUSION

Good corporate governance increases the long term value of a company and its potential for growth. It reduces risk, and strengthens reputation - key benefits which make corporate governance too important to be ignored by SMEs.