Achieving growth and adding value through corporate governance

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How can corporate governance help to build a business? We asked Professor Mak Yuen Teen, Associate Professor at the National University of Singapore Business School, to share his insights with *Good to Go*.

Why is it important for SMEs to have corporate governance?

Any company that leverages funding from capital markets through a listing is expected to follow corporate governance frameworks and codes. If it chooses not to adopt recommended guidelines, it must explain why.

Often, such frameworks and codes are developed primarily with larger listed companies in mind, rather than SMEs. But whatever the size of the company, and even if it is not listed, having a good corporate governance framework is still important.

Take the issue of trust, for example. If you're an SME that counts several large, listed global companies among your customers, you will probably find that these companies are growing increasingly concerned about the ethics, governance and compliance of their partners and suppliers, and any associated legal and reputational risks.

In Singapore and the surrounding region, the haze issue has led to a lot of questions about the supply chain and whether companies are effectively 'outsourcing' their unethical practices to suppliers further down the line. The same questions are being asked about bribery, corruption and other socially irresponsible practices.

This is where corporate governance comes in. A good framework that is properly implemented will help SMEs safeguard their assets; build the trust of investors and other company stakeholders; and make decisions more effectively, efficiently and transparently.

What are some of the common barriers to adoption?

An overriding issue for most SMEs is that they have limited resources and face considerable pressure to generate cash flow and profits in the short term, so they often ignore the importance of corporate governance or do the minimum to demonstrate compliance.

But this means they can end up appointing the wrong kinds of directors on their boards to meet requirements for independent directors, and have poor internal controls and risk management processes. Global surveys have shown that, on average, SMEs are more prone to fraud and other wrongdoings, and suffer losses that are proportionately larger than those of larger companies. For SMEs, fraud and wrongdoing may result in the closure of the company.

So what should a sound corporate governance framework consist of?

The basic building block is for the top management – the founder or major shareholder, the directors and the senior management team – to set the right tone. For an SME, it is important to have a competent board with individuals who are able to constructively challenge and advise management.

Other elements include having adequate internal controls and risk management processes, good internal and external reporting systems, and an internal audit function suitable for the company. It is also important to have an external auditor who provides a value-for-money audit of the financial statements required to satisfy the financial reporting needs of external shareholders and stakeholders – as is having an appropriate system for developing critical skills and high performers, and maintaining proper communication with investors and key stakeholders.

Could you tell us more about the new Governance Evaluation for SMEs (GEMS), and how it's different from other corporate governance ratings and scorecards?

I've helped develop a number of governance evaluation methodologies over the years and have long felt that these did not really take into account the most important corporate governance issues for SMEs. So I approached the Securities Investors Association (Singapore) and other partners about developing GEMS, which was launched earlier this year.

It includes factors that are particularly relevant to listed SMEs, such as whether the largest shareholder remains committed to the company, and whether there is another large investor – unrelated to the largest shareholder – that can act as a check and balance.

We also evaluate corporate governance over a three-year period, and we only include SMEs that have been listed for at least three years. This allows us to look at corporate governance factors over a period of time, rather than on an annual basis, and assess the SMEs' track records.

Could you provide some examples of how GEMS will benefit SMEs and investors?

We believe SMEs that focus on the factors we have included will be able to improve their governance and performance over time, and attract investors.

Other countries have also showed considerable interest in the initiative because, to our knowledge, it's the first time a governance methodology has been developed with SMEs in mind. We think there is potential in developing funds that focus on investing in well-governed SMEs, and GEMS could act as a tool for identifying who they might be.