



# Best Practice in SME

Recommendations for the Direction and Control of Small and Medium-sized Enterprises

**Practice-proven BoD Tools and Check Lists** produced by the CCG Partners can be obtained free of charge by visiting the website of the IFPM Center for Corporate Governance of the University of St.Gallen, Switzerland, and clicking on the title link: [www.ccg.ifpm.unisg.ch](http://www.ccg.ifpm.unisg.ch) (→ «Best Practice»)

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## **Initial Position: The great value of self-regulation**

We are of the considered opinion that the building-up of direction and control based upon self-regulation instead of ever more state controls, will contribute added value to Swiss small and medium-sized enterprises and the Swiss economy. Self-regulation actually has a different objective: striving for the best possible SME practice instead of mere compliance with statutory minimum requirements. The effort of SMEs to measure themselves against high quality objectives will not only further the Swiss SMEs in international competition but also serve to ensure ongoing employment and social prosperity.

## **Goal of, and audience for these recommendations**

These recommendations should serve as a basis for

**S**mall (10 to 50 employees) and  
**M**edium-sized (up to 500 employees)  
**E**nterprises (in the form of unlisted Swiss corporations)

to ensure the exercise of responsible and sustainably value-added direction and control after the completion of the start-up period. Successful SMEs always further long-term satisfaction and voluntary loyalty of:

- customers and suppliers,
- employees and the general public, as well as
- the owners of the enterprise.

These recommendations present handy and simple direction and control instruments and contain best practice advice for entrepreneurially managed SMEs. The recommendations are to serve their audience as a means of reflection. Divergences should be reasonably justifiable.

With regard to small enterprises and other businesses in the start-up period, these recommendations can be taken as an incitement.

## Opportunities for SMEs

SMEs can be successful on a sustainable basis when they:

- emulate other exemplary enterprises,
- adopt the merits observed in these,
- simultaneously exploit the particular capabilities of the SME, such as flexibility, quick decision-taking processes and the long-term time horizon of their owners, and
- possess a unique corporate strategy.

## Structure

The recommendations are divided into four levels based upon the four pivotal success factors for the effective direction and control of the SME:

- ❶ **Situational Level:** Due consideration of particular circumstances within the SME
- ❷ **Strategic Level:** Targeted direction of the SME
- ❸ **Integrated Level:** Efficient BoD and EM teams in the SME
- ❹ **Controlling Level:** Effective supervision within the SME

N.B.:The abbreviations 'BoD' and 'EM' stand for 'Board of Directors' and 'Executive Management', respectively.

## ① **Situational Level:** **Due consideration of particular circumstances within the SME**

### **1.1 The advantages and disadvantages of the SME**

The following possible **advantages** should be exploited for the effective direction and control of the SME:

- + long-term business horizon, seen from an economic, social and ecological perspective
- + the enabling of generating added value for customers, employees, the owners, and society
- + simple and flexible structures
- + quick decision-taking processes
- + practical formal and distinctive informal forms of communication

The following possible **disadvantages** should be actively counteracted for the sake of effective direction and control of the SME:

- lack of time and often lack of know-how in the area of strategic management
- lack of attraction for qualified job candidates
- lack of financial resources for the of growth financing
- lack of succession planning

### **1.2 Ownership interests within the SME**

The shareholders of the SME should lay down a comprehensive ownership strategy which reflects the ownership interests and is to be periodically reviewed and revised as required.

The ownership strategy should comprise in particular of the following aspects:

- corporate vision
- independence
- focus on results
- awareness of responsibility towards, customers, owners, employees and society
- management structure
- innovation orientation
- growth
- financing

- risk policy
- dividend policy
- shareholders' agreement
- treatment of minority shareholders
- succession planning

The shareholders should have no entitlement to instruct the BoD and the EM and should only possess statutorily restricted rights to information and inspection.

### **1.3 Family interests within family SME**

In small and medium-sized family enterprises, a family strategy should be developed (e.g. re the treatment of minority shareholders and deadlock procedures). In family enterprises, the same personal, professional, social, and managerial competences should be demanded from family-member directors and family-member managers as from external candidates.

### **1.4 Size of the BoD**

The size of the BoD should be dependent upon individual situations. We recommend 3 directors for small enterprises (up to 50 employees) and 5 directors for medium-sized enterprises (up to 500 employees).

### **1.5 Structure of the BoD**

The BoD should comprise of an independent chairperson as well as an additional independent member. A vice-chairperson is to be elected.

The secretary of the BoD should not be a member of the BoD and, as far as possible, be independent.

A person is deemed independent when no situational circumstances exist which could encroach upon his or her free opinion-forming towards the shareholders, the BoD or the EM.

## ② Strategic Level: Targeted direction within the SME

### 2.1 Main duties of the BoD

Under Swiss Company Law, the BoD has essentially four inalienable and nontransferable duties («The **4 S**»):

- **Strategy:** the BoD ensures the future well-being of the SME, lays down the strategic objectives, determines the resources for their achievement and provides for an ongoing balance between objectives and resources
- **Systems:** the BoD sets up the organisation and is responsible for the structuring of the accounting system, the financial planning and financial controls as well as for risk and crisis management
- **Staff:** the BoD is responsible for the appointment and removal of the persons entrusted with the management
- **Supervision:** the BoD fulfils an exemplary function and is responsible for the corporate culture as well as for the ultimate supervision of the persons entrusted with the management. The BoD is to ensure compliance with the law, regulations, directives, and ethical guidelines.

### 2.2 Corporate strategy in the SME

The BoD and the EM are to formulate a corporate strategy on the basis of the strategy laid down by the owners of the company. This corporate strategy should be periodically reviewed and revised as required. The development and implementation of such a strategy is to be clearly embedded within appropriate procedures and comprises the following six main stages:

- **Situational analysis:** competitive position, capabilities and core competences, summarised in strengths and weaknesses
- **Outlook:** analysis of future trends as well as developments in the market and with competitors, the deducing of alternative scenarios, summarised in opportunities and threats
- **Strategy:** vision (derived from the ownership strategy), strategic direction of impact regarding products/services, target markets (market segments and regions), depth of added value and innovation, as well as financing
- **Resolution:** approval of strategy documentation by the BoD
- **Measures:** the setting-up of the organisation, programmed measures and budgets
- **Controls:** periodic (e.g. quarterly or half yearly) verification of measures for implementation and their effectiveness for the achievement of corporate objectives.

The BoD should suggest changes in the ownership strategy to the shareholders if, on the basis of the given ownership strategy, no success-promising corporate strategy can be developed.

## **2.3 Clarification of roles between BoD and EM**

The BoD is the strategic organ of the SME. The BoD provides the strategic prerequisites, approves the corporate strategy and monitors its implementation. The EM develops and implements the corporate strategy.

The BoD delegates operative management to the EM.

In critical situations, the BoD needs to deal with the affairs of the enterprise particularly intensively, to devote additional time to the enterprise as well as to intervene operatively as the situation requires.

## **2.4 Requirements of the members of BoD and EM**

The successful direction and management of an SME requires the members of the BoD and EM to be personalities of integrity and commitment possessing professional as well as leadership and social competences.

## **2.5 Organisational regulation**

An organisational regulation is mandatorily necessary for a delegation of management activities to the EM. It should regulate the functions and collaboration of the BoD and the EM, in particular:

- apportionment of duties, competences and responsibilities between the BoD and the EM
- signatory power (joint signatory power)
- frequency of meetings of the BoD (at least 4 times annually, with subject matter emphasis as per management calendar for corporate strategy, finance, human resources/organisation, markets/products as well as risks/opportunities)
- quorums for the passing of resolutions and requisite majorities, possibility of taking resolutions by circular and telephone conferences
- minutes of meetings and proper record of pending items
- regulation of internal and external communication.

The organisational regulation is to be issued by the BoD and should be regularly reviewed.

## **2.6 Decision-making within the BoD**

With regard to important decisions, the BoD should give due consideration to the relevant interests of the various stakeholders. For this purpose, each member of the BoD should conduct a SWOT analysis from a different stakeholders' point of view: «Four Hats Principle» (including customers, owners, personnel, society).

## **③ Integrated Level: Efficient BoD and EM teams in the SME**

### **3.1 Constitution of the BoD**

The BoD should function as a team on the basis of a culture of trust.

In addition, the BoD should be constituted on the basis of the following criteria:

- Members of the BoD should possess in breadth the same know-how as the members of the EM, in order to exercise the direction and control functions effectively
- Members of the BoD should be equipped with various role skills relevant to the business of the SME, such as for example the roles of the critical thinker, the controller or the innovative thinker
- The BoD should comprise of at least one female member in a smaller enterprise and two to three female members in larger enterprises. This is to assure more success relevant diversity in the decision-taking process.

### **3.2 Chairperson of the BoD**

The chairperson of the BoD is to lead by example and should make every effort to achieve a constructive open corporate culture of trust between the shareholders, the BoD, the EM and the workforce. The chairperson of the BoD is responsible for upholding the interests of the enterprise, the introduction of new ideas, the elaboration of current challenges as well as the effective preparation and chairing of the meetings of the BoD. The chairperson of the BoD should ensure the provision of punctual and relevant information to the entire board of directors.

The chairperson of the BoD is to ensure that the BoD entrusts different members (or possibly committees) with particular assignments in the areas of controlling and risk management, as well as in other relevant areas of competence.

### **3.3 Avoidance of conflicts of interest**

All members of the BoD and the EM are to avoid conflicts of interest. In case of any conflict of interest arising, such is to be reported to the chairperson of the BoD. The chairperson of the BoD should then be responsible for proposing an adequate resolution on the matter (generally in the absence of the member affected) to the BoD.



### **3.4 Objectives and assessment of BoD and EM**

The BoD has to periodically assess its capabilities as a corporate organ. In coordination with the other members of the BoD, the chairperson of the BoD must annually assess the capabilities of the members of the EM who are directly reporting to the BoD and must review the President's assessment of the other members of the EM. All assessments are to be conducted on the basis of prior agreed qualitative criterias and quantitative objectives.

### **3.5 Remuneration of BoD and EM**

The BoD is to ensure that the SME comprehensively remunerates the members of the BoD, the members of the EM and the employees, based on internal fairness, external equity and competitive company performance. Remuneration by way of directors' fees to members of the BoD are recommended to be of the order of that paid to strategy advisors used by the SME.

### **3.6 Induction of BoD and EM**

The BoD is to ensure a suitable induction of newly elected members, and an adequate advanced training of members of the BoD and the EM.

### **3.7 Succession planning**

The BoD is to undertake early and careful planning of the succession of BoD and EM members.

## **④ Controlling Level: Effective supervision within the SME**

### **4.1 Information**

The chairperson of the BoD and the president of the EM are to ensure the provision of punctual, relevant and transparent business information.

### **4.2 Communication**

The chairperson of the BoD and the president of the EM are to ensure a mutual corporate culture of trust. This represents the basis for sustainable business success.

### **4.3 Reporting (MIS)**

The BoD is to ensure a strategic system of reporting which is adjusted to the requirements of the SME and enables the necessary control and supervision of the SME. The reporting system should include all relevant details for direction and control activities, including a liquidity plan for the impending 12 months as well as a comment prepared by the EM. As a rule, monthly reporting is necessary.

### **4.4 Risk Management**

The BoD is to provide an expressive integrated and SME-g geared system of risk management. All SME business areas and procedures should be analysed for sources of risk. In other respects, opportunities should be taken and threats avoided, in order to be able to take calculated risks.

### **4.5 Compliance with regulations**

The BoD is to introduce regulations for compliance with appropriate legal and ethical standards.

#### **4.6 Storing of minutes**

The BoD has to ensure suitable and sufficient storing of minutes of its meetings which record its deliberations and resolutions passed. With regard to the EM, records within the minutes should only be that of resolutions passed. The BoD and the EM are to keep proper record of pending items.

#### **4.7 Financial auditors**

The BoD has to propose to the general meeting of shareholders the election of competent and independent financial auditors. The BoD is to obtain an assessment of their effectiveness. For this purpose, the BoD or a delegated member thereof is to meet together with the financial auditors at least once each year.

#### **4.8 Annual report to the shareholders**

The BoD has a statutory duty to report to the shareholders on the activities of the BoD and the EM. The annual report for the past financial year is to be presented to the shareholders at the annual general meeting of the SME. A written form of the annual report should also include details of the effective direction and control of the SME.

#### **4.9 Evaluation of success**

The BoD has to conduct an annual success evaluation of the direction and control of the SME.



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