Who is watching your back? – A few practical tips for good corporate governance in a small business

Every time something goes wrong, it has most likely been because the watchman was asleep or away.

Hollywood movies of course mostly portray the watch man or security guard to be too inexperienced for the super hero (or thief); this is an exaggeration of course.

In real life, a company's watchman: The owner/manager, the board of directors, the independent financial advisor or lawyer is usually well experienced and can significantly help a company in its corporate governance.

But first, what is corporate governance?

Put simply: "It is the process by which the company's management is being monitored by someone else."

Secondly, why does this stuff matter, particularly for a Small Business?

In many cases, there is a direct correlation between companies failing (failing to take off, making losses, winding up) and not implementing proper checks and balances.

A personal example...

I will share one practical example from my past experience:

Our firm was asked to do an investigation for a client, a wealthy family who had invested over EUR 10m in some apartment buildings in Berlin, Germany.

The idea was brilliant: the Berlin property market was fast growing. There was money to be made!

The problem? The execution - they entrusted management of the property to two individuals, "a bunch of cowboys" I should say, and these guys did not care about controls:

- There were no regular minutes of meetings by the directors
- There were no regular management accounts
- There was no proper procedure set in place to ensure that proper monitoring/supervision of the construction works by the building contractors.

A few years later and the project was still not complete and making losses!

One of the guys was eventually kicked out, after a long legal process. The other, kept on, but he lost a lot of his powers.

And a global example...

Likewise some of the world's largest failures came down to bad governance (at least partly):

- *Enron (2001, an Energy Group):* Directors concealed large losses and their "watchman" the auditor- Arthur Andersen, one of the 5 largest audit firms in the world at the time, was not doing their job properly - because of huge consultancy contracts ("side deals") which made them less independent.

- *Lehman brothers collapse (2008, Financial services).* They were a bank offering mortgages to people who typically couldn't repay loans (sub prime mortgages). This category of lenders became a more than significant portion of their overall portfolio, eventually causing their collapse when the global credit crisis started.

  The problem? They had no watchman - ordinarily would have been a Government regulator. Unlike other typical banks who had rules on how much they could be exposed to a given sector, they were not, hence taking on a lot more risks from this category of borrowers. Of course, the whole story is more complex than I set out above, but you get the picture.

In small or startup companies, the problem is even worse:

The owner is the manager and the board and the employee. No controls, no external party to whom he is accountable.

You may argue that small companies have difficulty in access to financing and so cannot afford to pay.

But my challenge to them is this: Google and Apple both started in a garage, using their own personal money – and they had mentors to watch their back.

So what corporate governance tools can a small business put in place?

1. Business Partnerships

The importance: Rather than thinking you "know it all", how about asking a lawyer and accountant friend as well as a third completely independent but trusted business man to join your team as advisors.

If you cannot afford them, give them say 10% shares each. I believe that inherently every human being is good and wants to help another succeed. Money is not the ultimate motivator for many people; it is the satisfaction of being appreciated that ultimately motivates. For these "experts" the satisfaction and motivation will be to see their advice implemented and the business growing and becoming profitable.

The reward: The benefits of an independent team of advisors are that you gain invaluable advice you would not ordinarily afford from full time employees. You will even reap the profits. Otherwise, what use is it to own 100% of a company that will make a loss when you can own 70% of a company that will make a profit?

Do the math; do not try to be a super hero to "go it alone." Find partnerships with people who can benefit you. Most successful businesses are large partnerships of sorts.

2. Think of your business as a franchise.

Can your business survive without you?

In one of my favourite books, *"The E Myth: Why most small businesses do not work and what to do about it"* the author, Michael Gerber makes a compelling case:

McDonalds is the most successful small business in the world.

He then says the following about the founder of McDonalds, Ray Kroc:

"Forced to create a business that worked in order to sell it, he also created a business that would work once it was sold, <u>no matter who bought it</u> (emphasis mine). Armed with that realization, he set about the task of creating a fool proof predictable business. A systems dependent business, not a people dependent business. <u>A business that could work without him</u> (emphasis mine again). Unlike most small business owners before him- and since- Ray Kroc went to work on his business and not in it.

He began to think about his business like an engineer working on a pre production proto type of a mass produce able product"

In other words, put in place a "how we do it guide", or if you like "the complete idiots guide to how to….". This detailed written systems and procedures, including who does what and how will ensure the business can work, without you, using the <u>lowest possible skilled labour</u>.

If you are too busy to do this or cannot afford a consultant why not get one of your employees to do it. Someone who loves writing. You do not need to have complex flow charts and diagrams and tables of contents.

Start with something, the most important areas first, then move onto the details and the less important areas. Then test it by asking a completely inexperienced person to try to read and understand.

3. Weekly (or monthly management reporting)

How about a weekly email to your team (and advisors) to share updates on the business as well as challenges you are facing? Yes even with junior team members. You will be surprised at the brilliant ideas they can give to implement solutions and changes (and remember they are on the ground so will most likely have feedback from customers and experience with the market)

As I mentioned, it's not the brilliance of ideas that is most important, it is how you implement them.

4. The importance of bookkeeping

I saved the best for last.

The importance: Instead of doing the accounts yourself (or worse still not doing them and worrying about the tax man), why not find an accountant/bookkeeper who will even do the accounts on a quarterly basis?

There are many, many accountants (and bookkeepers) who are coming out of business schools every year and they are not that expensive. I know some who can even do it for Shs. 100k a month.

So even if you might not immediately afford a chartered accountant (say an ACCA qualified accountant), you can start somewhere, just don't sit down and do nothing about it!

The reward: Instead spend the time you save (and time is money) getting more customers and making your product the best. Spend it doing interesting things like how to improve customer service (and let the accountants remain boring doing boring books of accounts!)

From my vast experience in audit and assurance, I do know a few things about the importance of having a good corporate governance program.

I can tell you without a shadow of doubt that if you are expecting money from a third party (a lender, a venture capitalist, an angel investor) they will at one point in time want to see two things:

1. What your books/accounts look like

2. How the business is being monitored.

So where do you start?

1. Find a bookkeeper/accountant to remove the burden of your books from yourself.
2. Find a lawyer or business advisor to join your team in an independent advisory capacity.
3. Start preparing for your business to run without you.

We can help you in taking these first few steps but of course if you already have someone else in mind, excellent, but please don't do nothing, start taking those first steps!

Best of luck, and of course, if you need help, we can help you. Speak to us.

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