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# DFI CG TOOLKIT

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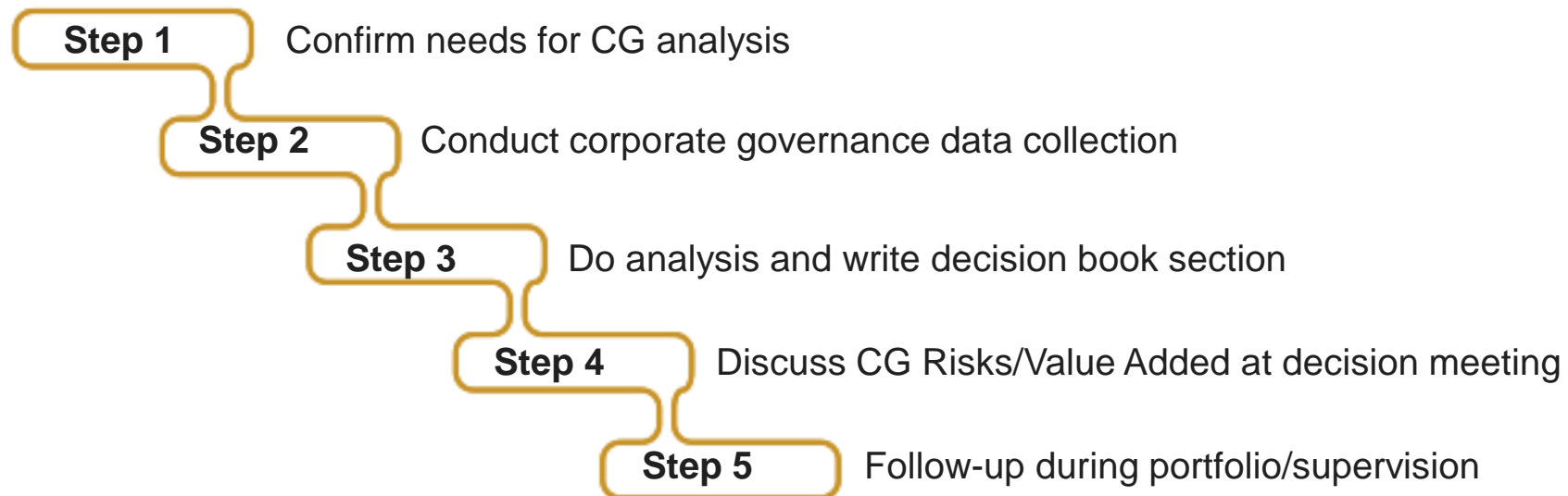
### Contents:

- CG Instruction Sheet
- CG Matrix
- CG Questionnaire (Report generator)
- CG Key Terms/Definitions
- CG Sample Report
- CG Sample Improvement Plan

# Section 3.1

## The Corporate Governance Assessment

### Steps in Corporate Governance Assessment process



# Section 3.1

## The Corporate Governance Assessment (CGR)

### Step 1: Confirm Paradigm

#### Objectives:

- ⑦ To form a firm view on whether corporate governance poses special risks or exceptional opportunity for value-added
- ⑦ To select the governance paradigm (or mix of paradigms) to be applied to the company

#### Tools:

- ⑦ Trained investment staff; common sense
- ⑦ CG Matrix

**When in Deal Cycle: AS EARLY AS POSSIBLE - Concept**

# Section 3.1

## The Corporate Governance Assessment (CGR)

Make sure you adapt the tools for your firm.

The CG Methodology can be adapted for each major type of client

5 Company **archetypes/paradigms** (*Find the various ones on the IFC website*)

- ⑦ Listed companies
- ⑦ Family- or founder owned unlisted companies
- ⑦ Financial institutions
- ⑦ Transition economy companies
- ⑦ SOEs

5 CG **attributes**—matching the 5 risks

# Specific Governance Issues for Family Companies

Family employment

Succession planning

Family salary-earners vs. dividend-receivers

Incentives for non-family managers



Formalities – they do matter

Treatment of outside financial stakeholders

Family's long-term role as shareholder (share retention/voting)

# Specifics of Bank Governance

Governance of banks / FIs goes deeper into operations than in commercial companies

- Delegation of authority
- Nature of the assets

Greater concern for adequacy of controls, auditing, reporting and oversight

- Implications for role, structure and composition of the board





# Banks/FIs – Areas of Special Attention

Risk identification and management

Operational, asset/liability, market

Controls; independent checks and balances; quality of information

Internal / external reporting

Related party lending

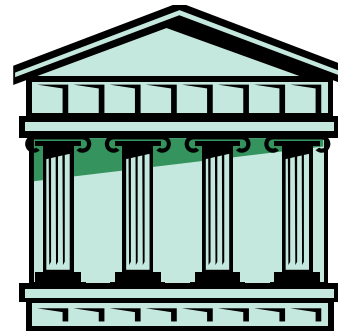
Asset quality

Credit


Portfolio review

Compliance

Anti-money laundering / combating financing of terrorism



# Specific Issues Facing SOEs

<b>POLITICAL INSULATION</b> <i>(or lack thereof)</i>	<b>BUSINESS OBJECTIVES</b>	<b>TRANSPARENCY</b>
<p><b>Ownership policy</b></p> <ul style="list-style-type: none"> <li>• Ownership entity</li> <li>• Legal form</li> <li>• How are votes held and exercised</li> </ul> <p><b>Competitive environment</b></p> <ul style="list-style-type: none"> <li>• Regulatory role</li> <li>• Level playing field</li> </ul> 	<p><b>Social / commercial objectives</b></p> <ul style="list-style-type: none"> <li>• Making money &amp; building value</li> <li>• Public goods, poverty alleviation, etc</li> <li>• Separating the two</li> </ul> <p><b>Financial discipline</b></p> <ul style="list-style-type: none"> <li>• Access to national budget/treasury</li> <li>• Exemption from bankruptcy laws</li> <li>• Access to state banks</li> </ul>	<p><b>Accounting &amp; reporting</b></p> <ul style="list-style-type: none"> <li>• State auditors - external auditors</li> <li>• Government accounting - IFRS</li> <li>• Disclosure to investors / media</li> </ul> <p><b>Board &amp; shareholder processes</b></p> <ul style="list-style-type: none"> <li>• Nomination evaluation of board</li> <li>• Role of board - political directorate</li> <li>• Treatment of minority shareholders</li> <li>• Citizens as shareholders</li> </ul>

# Once again...

Make sure you adapt the tools for your firm.

The CG Methodology may be adapted for each major type of client,

## 5 Company **archetypes/paradigms**

- ⑦ Listed companies
- ⑦ Family- or founder owned unlisted companies
- ⑦ Financial institutions
- ⑦ Transition economy companies
- ⑦ SOEs

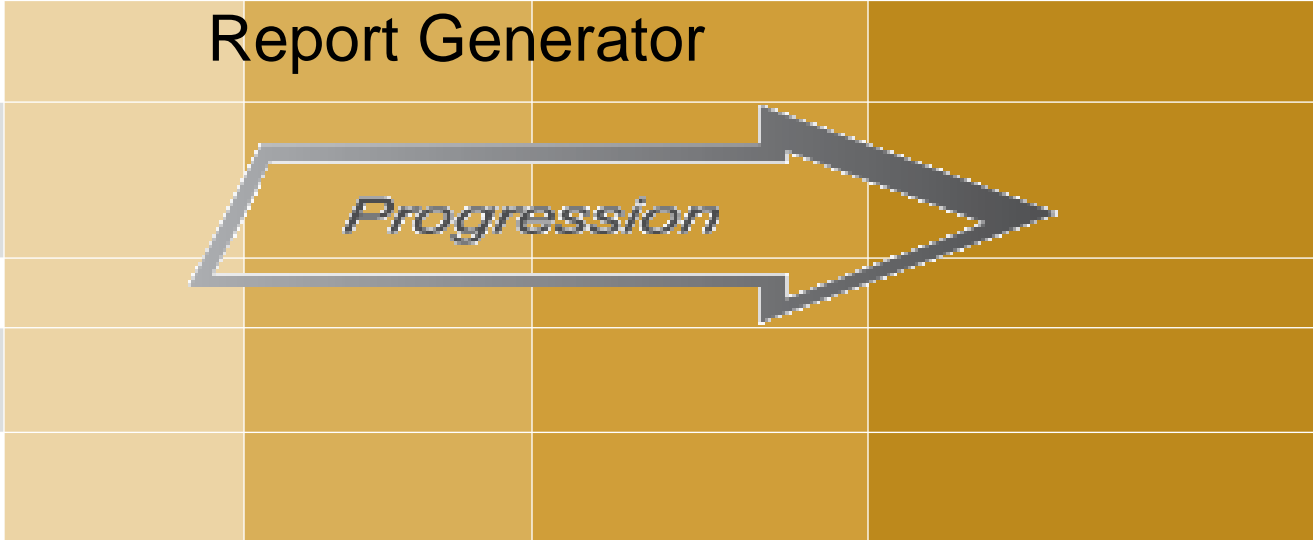
5 CG **attributes**—matching the 5 risks

## HAND OUT MATRIX

# Section 3.1

## The Corporate Governance Assessment (CGR)

### Core Tool—Simple Progression Matrices

	Level 1	Level 2	Level 3	Level 4
CG Attributes	Acceptable	Extra Steps	Major Contributions	Leadership
Commitment to Good CG	 <p>The diagram shows a grid with four columns (Level 1 to Level 4) and six rows (CG Attributes to Treatment of Minority Shareholders). A large grey arrow points from left to right across the grid, starting from the 'Extra Steps' column and ending at the 'Leadership' column. The word 'Progression' is written in italics inside the arrow. The text 'Report Generator' is centered above the grid.</p>			
Structure and Functioning of the Board of Directors				
Control Environment				
Transparency and Disclosure				
Treatment of Minority Shareholders				

# Section 3.1

## The Corporate Governance Assessment (CGR)

### Step 2: Conduct the Corporate Governance Data Collection

#### **Objectives:**

- ⑦ On site evaluation of the client's governance
- ⑦ Follow up on issues identified in first impressions/initial client contact
- ⑦ Gain sense of the commitment to good CG
- ⑦ Help identify key allies and CG champions within the company

#### **Tools:**

- ⑦ CG Assessment Generator
- ⑦ An inquisitive mind

**When in Deal Cycle: Appraisal / Due Diligence / Site visits**

## HAND OUT QUESTIONNAIRE

# Section 3.1

## The Corporate Governance Assessment (CGR)

### Core Tool—Questionnaire (Report Generator)

#### Arranged around the 5 risk and additionality areas

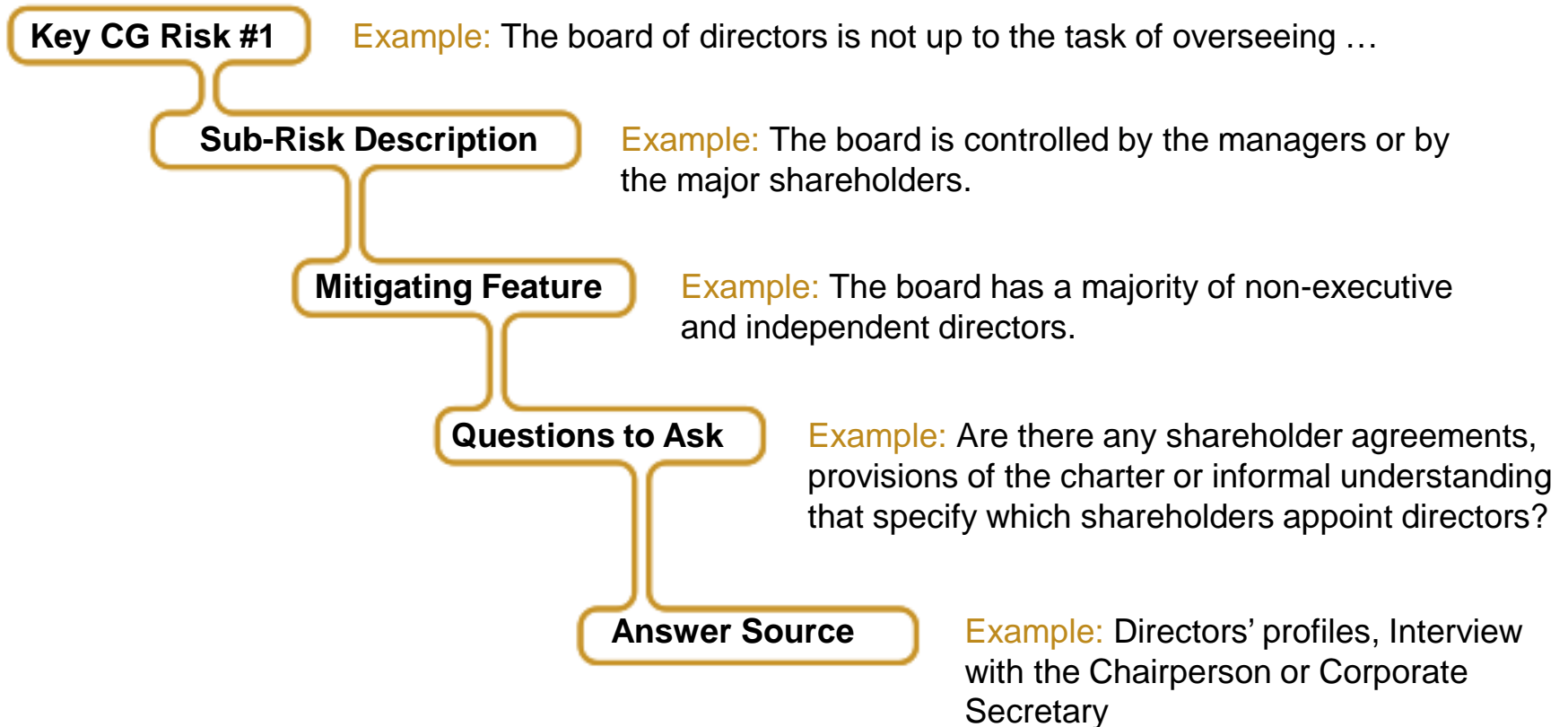
- Risk 1** The board of directors is not up to the task of overseeing the strategy, management and performance of the company.
- Risk 2** The company's risk management and controls are insufficient to ensure sound stewardship of the company's assets and compliance with relevant regulations.
- Risk 3** The company's financial disclosures are not a relevant, faithful, and timely representation of its economic transactions and resources.
- Risk 4** The company's minority shareholders' rights are inadequate or abused.
- Risk 5** The IFC potential investee company and its shareholders have not demonstrated commitment to implementing high quality CG policies and practices.



# Section 3.1

## The Corporate Governance Assessment (CGR)

Core Tool: Report Generator – Details what to look for and what to recommend



# Section 3.1

## The Corporate Governance Assessment (CGR)

### Step 3: Do CGR Analysis and Write Decision Book Selection

#### **Objectives:**

- ⑦ Make clear conclusions on the 5 chief CG risks and any other special client features
- ⑦ Identify any needed covenants for term sheet
- ⑦ If needed, develop simple recommendations for implementation by clients
- ⑦ Achieve client “buy-in”, agree on a timetable, areas where IFC can help
- ⑦ Reflect CG Assessment in the decision book’s Appendix

#### **Tools:**

- ⑦ Sample documents: Decision book sections, Model equity term sheets
- ⑦ Other CG resources on specific topics or countries, e.g. independent director definition, exchange listing rules – see the CG Unit website

#### **When in Deal Cycle: Appraisal/Investment Review**

## HAND OUT SAMPLE REPORT

# SAMPLE REPORT FOR IRM: Corporate Governance Assessment “Takin Ltd.”

CG Risk	Risk	Covenants/Mitigants
<b>1. Structure and Functioning of the Board</b>	Moderate	<b>Mitigant:</b> Five non-executive, non-family directors on 13 member board; Vigorous board discussions <b>Comment/Recommended covenant:</b> An audit committee
<b>2. Control Environment and Processes</b>	Moderate/High	<b>Mitigant:</b> Absent <b>Comment/Recommended covenant:</b> Poor controls over related party transactions; Exposure to transfer pricing risks. Arm’s length covenants are recommended
<b>3. Transparency and Disclosure</b>	Low	<b>Mitigant:</b> Listed company; Repeat IFC client with international auditor <b>Comment/Recommended covenant:</b> Implement audit committee
<b>4. Treatment of Minority Shareholders</b>	Low	<b>Mitigant:</b> Non-executive directors very vocal <b>Comment/Recommended covenant:</b> Arm’s length covenants
<b>5. Commitment to Good CG</b>	Low	<b>Mitigant:</b> Listed company with organic documents; Basic rules on family employment <b>Comment/Recommended covenant:</b> None

**Conclusion:** Repeat IFC client, committed to CG improvements. In sum, the corporate governance risks are low.

**Scope:** We were able to cover all issues.

**Implementation:** The local CG Advisory Project was contacted for assistance in setting up an audit committee. Client will pay the fees for this support.

**Other:** N/A

# SAMPLE REPORT FOR IRM: Corporate Governance Assessment “Federal Campesinos”

CG Area	Risk	Covenants/Comments
<b>Commitment to Good CG</b>	Moderate	<b>Recommended covenant:</b> None <b>Comment:</b> Democratic co-operative social pact and established legal framework
<b>Structure and Functioning of the Board</b>	High	<b>Recommended covenant:</b> (i) Appoint 1 independent director; (ii) Establish a nominations committee; (iii) Split CEO/chairperson role <b>Comment:</b> Board member’s selection inappropriate; Lack of “check and balances”; Apparent concentration of power in CEO/Chair; No independents; 5 year director term
<b>Control Environment and Processes</b>	Moderate	<b>Recommended covenant:</b> Establish a proper audit committee <b>Comment:</b> Risk of management override of controls; CEO chairs the audit committee
<b>Transparency and Disclosure</b>	Moderate/Low	<b>Recommended covenant:</b> Establish a proper audit committee <b>Comment:</b> Newly appointed auditor
<b>Treatment of Minority Shareholders</b>	Low	<b>Recommended covenant:</b> None <b>Comment:</b> One vote per member regardless of holding; Democratic process appears to end in stymied election of FC’s board
<b>Other CG issues; Financial discipline</b>	Low	<b>Recommended covenant:</b> None <b>Comment:</b> Commercial basis of operations

**Conclusion:** IFC must design its debt instrument to mitigate risks as much as possible.

**Scope:** Limited assessment work but recommendations are commensurate with work done.

**Other:** (i) Deep democratic CG process; (ii) Client Serves BOP ( high grassroots participation); (iii)Recent removal of state influence

**Implementation:** Some of the recommended changes address allocation of power and are usually impossible to achieve post-disbursement.

## HAND OUT SAMPLE CG Improvement report

# Section 3.1

## The Corporate Governance Assessment (CGR)

### Step 4: Answer Questions on CG Risks/Value Added at Decision Meeting

#### Objectives:

- ⑦ Approving Directors/Managers may ask questions to ensure that the 5 corporate governance risk has been mitigated – IO must prepare strong justifications
- ⑦ Where CG additionality has been given as an institutional role, clear reasons and follow-up actions to be provided
- ⑦ If a director is to be nominated then a clear assignment should be presented

#### Tools:

- ⑦ Completed CGR Report
- ⑦ Term sheet
- ⑦ Directorship assignment template

**When in Deal Cycle: Decision meeting & Board**

# Section 3.1

## The Corporate Governance Assessment (CGR)

### Step 5: Follow-up in portfolio/supervision

#### **Objectives:**

- ⑦ Adherence to the agreed terms and conditions/CG improvements
- ⑦ Identifying further CG assistance from outsiders (e.g. consultants, director sourcing/ training, etc.)

#### **Tools:**

- ⑦ Supervision check list
- ⑦ Other CG resource on the website

#### **When in Deal Cycle: Pre & Post Disbursement**



## Section 3.2

# The Corporate Governance Assessment(CGR)

### Corporate Governance Assessment: Main tasks

When?	What?	Average Time*	Result/Outputs/Comment
<b>Before the Assessment</b>	Set expectations with the client,		Explain why the Assessment is being done, explain the importance of CG in the appraisal process, make the business case for CG, explain what the Assessment itself will entail, time commitment, and how the CG Assessment is to be used once completed
<b>Before the site visit</b>	Assessment corporate governance written policies	2 weeks (could be less if no complex CG work)	Officer can start the analysis
<b>Site visit</b>	Interview key stakeholders incl. shareholders, board, senior management, external auditors/advisors, family)	2-3 days	Follow up with general presentation on preliminary findings and recommendations —for the Board and senior managers
<b>Post site visit</b>	Analyze collected information	1-2 weeks (including the client feedback and revisions)	Corporate governance assessment report (analysis of strengths and weaknesses with recommendations for improvement)
<b>Pre-IRM</b>	Write the assesment report and covenants	Varies (working with IOs to negotiate with the client)	CG presentation may be made to client on advisory for fee basis

Thank You

So we have some tools ...now what??



# Applying the Methodology

Selection of Clients

Questionnaires and Document Request Lists

Document Review

Conducting Interviews

Drafting the Assessment

Developing the CGIP

Implementation and monitoring

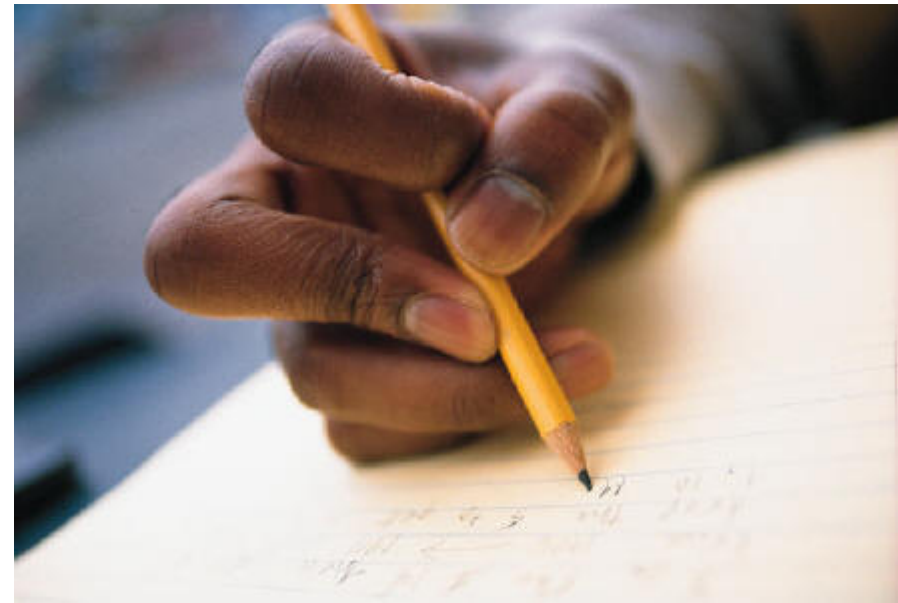
# Practical advice: analysis of documents

## Analysis of documents

What is written is important, but ...

We assess practices, and not documents

Thus, it is important to check the extent to which what is written is true



# Practical advice: interview



Interview one-to-one

Explain your goal to each person

Get prepared (info about the company, facts, history, analysis of documents) – saves time!

Verify facts with different people even if that's not their area – you need to know their attitude

Make the interview interesting, listen

Don't follow the questionnaire – it has to be a friendly and informal discussion (although, control the situation!)

Take contact details, agree you can call if clarifications needed

# Writing the Report

Target Audience – directors, managers, shareholders

Length – up to your management – make it appropriate for your audience (internal v external)

Evaluate both company documents and practices

Both legal and financial disclosure specialists should be involved

Verify things that sound particularly troublesome before putting them in the report

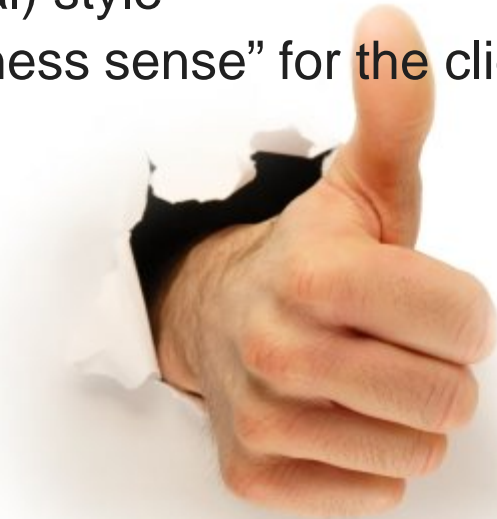
Follow the Report Structure



# Writing the Report

## Writing tips

- Tailor solutions to the particular client, given their structure, size and motivation for improving CG
- Avoid a “box-ticking” or “cookie-cutter” approach
- Be analytical – do not simply restate facts
- Praise the good; suggest how to improve the bad
- Use an easy to read business (not legal) style
- Recommendations should make “business sense” for the client (not create new problems)
- Be firm but polite





# Practical Advice

Dig for issues in the assessment. Don't wait for problems to appear.

Make recommendations specific to the company

Keep a single team together for each client

Need time to build trust with companies

Advise on general CG rather than specific transactions

Stay focused on core topics – don't be afraid to say NO

Work with Board of Directors (key players in CG) – ensure you have their support

# Report structure– key components

## Background information about a company

- Background information about a company and its activities
- Ownership structure
- How motivation to improve CG reflected in business strategy (plan to list/IPO; plan to find investor)

## Corporate governance practice analysis

- Commitment to CG
- Supervisory board practices
- Executive body practices
- Control environment
- Disclosure and transparency
- Shareholder rights

## Summary (summary of recommendations)

# Commitment to CG principles

- Awareness of corporate governance by a company
- Motivation for improving CG
- Presence of charter and by-laws, their brief characteristics
- Presence of corporate secretary position, etc.

Your expert opinion!



# Board practices

Generally – the board's role in a company (formal, active etc.

Board composition (quantitative/qualitative/skill mix)

Practice of holding meetings (regularity, issues under review, whether board members prepare for meetings, minutes etc.)

Remuneration

Committees

Board assessment/evaluation (if any)



Your expert opinion!

# Executive body practices

Role of the executive body

Composition (if collegial), or an individual director's profile

Practice of board meetings

Relations between the board and the executive body, their interaction, quality of those relations, communication/reporting

Succession planning

Assessment/evaluation, etc.

# Transparency and Disclosure

Financial reporting (standards used, consolidated, not consolidated)

Degree of disclosure to shareholders, third parties, governmental bodies (only what is required by law or more; whether ownership structure is disclosed etc.)

Your expert opinion!



"I know nothing about the subject,  
but I'm happy to give you my expert opinion."

# Internal Audit and Internal Control

External audit

Internal control system

Audit committee, audit commission

Internal audit department

Your expert opinion!



# Shareholder rights

General meeting (AGM) - preparation, the AGM itself, frequency

Company registrar

Related party transactions/conflict of interests

Dividends

Charter capital increase/ decrease – share issuances

General treatment of shareholders (majority and minority ones)

Your expert opinion!



## HANDOUT CGIP

# CG Improvement Plan

Should be designed by project team **WITH** the company

Include a timeline

Set realistic deadlines and goals

Designate who is responsible for what

Advise on changes to corporate documents with client's legal team

Don't force things on the client

See sample improvement plan/ workplan



# What can be included

Specific trainings, workshops

Consultations on improving corporate governance

Corporate documents revisions

Advice on financial reports

Help in organizing AGMs and orientation sessions for BoD

Developing the roles of Corporate Secretary and Controller

Advice on how to approach investors and obtain sources of financing

# Implementing improvements

## General tips

Don't do the client's work for them

The client should drive the process; we advise

## Problems and pitfalls

How to manage expectations

Beware the client that thinks you are their legal department

Beware the client that disappears and comes back with everything finished

What to do with waning interest

Encourage the company to promote its improvements

# Completing work with the Client

## Completion letter

Identify issues selected for the workplan

Outline what was done to implement improvements

Make further recommendations / suggestions that the client can implement on their own

# Monitoring progress and impact

Keep in touch with the client - 6, 12 and 18 months later

Ask them about improvements they have made and the impact they have had on their company

Write up Success Stories to generate a demonstration effect

