

Corporate Governance Assessment Progression Matrix for Family or Founder-Owned Unlisted Companies

Instruction Sheet

Incoming Monthly





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The Governance of Family-owned or Founder-owned Unlisted Companies

Family or founder-owned unlisted companies are the most common type of company in almost all IFC's client countries. Family or founder-owned unlisted companies are defined as companies in which the founders or the founders' families have either complete ownership or effective control of the company and, usually, a significant role in company management.¹ Family companies are particularly predominant among medium and small companies, but in many markets even most large companies have a family as their controlling shareholder. The complex interaction of the family and the company that it controls creates additional governance challenges to those faced by other companies, including: succession planning for the family management; family versus non-family employment and promotion; equitable treatment of non-family shareholders; and the role of family meetings vis-à-vis Board meetings and shareholders meetings. The primary focus of IFC's family company paradigm is on unlisted family companies. However, many of IFC's largest investee companies are listed companies with a family as the controlling shareholder. For these clients, the family-company paradigm should be used in tandem with the listed-company paradigm.

Using the CG Tools

Eight key corporate governance (CG) tools are used for analyzing the governance of potential IFC investee companies. The Instruction Sheets, Progression Matrixes, Document and Information

Request Lists, the Corporate Governance Review Report Generator and the Sample CG Improvement Programs have been adapted for the Family Company Paradigm, the Model Independent Director Definition, the Supervision Checklist, Sample CG Improvement Programs or Sample Decision Book Section and the explanatory note "Why Corporate Governance?" are applicable across all six paradigms, without any adaptations.

1) Instruction Sheet—Family Companies. The purpose of this Instruction Sheet is to describe each of the key CG tools, how they should be used, and who should be interviewed in the course of either a Corporate Governance Assessment or a Corporate Governance Review.

2) Why is Corporate Governance Important? This note explains IFC's approach as value-added for clients. *This explanatory note should be given to the client at the earliest opportunity in the pre-appraisal.*

3) Progression Matrix—Family Companies. The Progression Matrix relates six areas of governance (Commitment to Good CG, the Board of Directors, Control Environment, Transparency and Disclosure, Shareholders Rights and Governance of Stakeholder Engagement to four levels of achievement. The matrix framework emphasizes the importance of ongoing improvements in the governance practices of clients, rather than trying to apply rigid minimum standards. In particular, the Progression Matrix allows clients to assess the governance of their own company against a simple framework.

The Progression Matrix should be given to the client at the earliest opportunity in the pre-appraisal.

4) Document & Information Request List—Family Companies. This list of questions and requests for documentation establishes the basis for the Corporate Governance Assessment (CGA) of an IFC client. The Document and Information Request List is organized along the same lines as the six areas of governance in the Progression Matrix. *For a CGA, The Document and Information Request List should be circulated to the company at least three weeks in advance of the onsite visit.* The company should identify a single officer who will be charged with responding to The Document and Information Request List by providing brief written answers of one or two paragraphs to each of the questions and delivering these to IFC prior to the onsite CGA. For the Corporate Governance Review (CGR), the investment officer must collect the required information from the documents or from interviews during the appraisal. If the investment officer elects to send a specially prepared CGR Document and Information Request List ahead of the site visit, an amended "questions only" version of the CGR Report Generator should be sent to the client. Discussions relevant to IFC's understanding of the governance of a company will arise throughout the appraisal and diligence process. Therefore, IFC Investment staff are encouraged to edit The Document and Information Request List (CGA or CGR) as necessary before sending them to the client, to avoid duplication.

¹ In many family firms the founder or the founder's family will maintain complete ownership of the company, while in others they will have a legally defined controlling stake. However, in some cases, the controlling stake may be de facto, rather than de jure, with the family exercising effective control or significant influence, even though a single-family bloc does not own the majority of the shares.

5) Corporate Governance Review Report

Generator: This document is intended for use by Investment Officers (and CG Officers, in the case of detailed reviews) in conducting a CGR; preparing the corporate governance section of an Investment Review Memorandum; responding to questions from Director at the Investment Review Meeting; and in presenting any major issues to the IFC Board. The CGR Report Generator uses negative assertions on each area of risk, and then using questions to frame the risk issue and identify and assess relevant company practices and procedures, helps Investment Officers to determine the level to which the company mitigates the risk. The Investment Officer is required to collect information about the company and report in the Decision Book CG section which features are displayed by the client and which are not. The CGR Report Generator aids Investment Officers in preparing this CG section as it indicates the data that must be collected from the client and provides guidance on how to collect this information by interviewing individuals at or contracted by the company, or by reviewing a specific legal document.

6) Model Independent Director Definition. Perhaps the most common governance recommendation is to increase the board's independence from both the management and the controlling shareholders. However, to achieve genuine board independence, it is crucial to carefully define what it means for directors to be "independent." This Model Independent Director Definition is often used during

discussions with the client to clarify the assessment of the current board and its future needs.

7) Sample CG Improvement Programs or Sample Decision Book Section (for CGRs). Sometimes, a CGA results in the need for the client to develop and implement a Corporate Governance Improvement Program (CGIP). The CGIP should always be tailored to the circumstances and priorities of the company. However, sample CGIPs give a good idea of what has been negotiated with clients in the past; therefore, they can be used as a reference point in the drafting process. The Corporate Governance Review (CGR) always generates a section for the Decision Book, and sometimes this will include recommendations for improvements.

8) Supervision Checklist. The Supervision Checklist provides a list of key issues that Investment staff should consider while supervising IFC investee companies and, in particular, those companies undertaking CGIPs.

Corporate Governance Interviewees

To carry out a thorough corporate governance analysis (CGA or CGR), IFC staff need to have direct discussions with people who play a variety of governance roles in the company. Following is a list of the people who would typically be interviewed. However, companies may differ significantly in how they apportion responsibilities and in the corporate titles they use for different positions in the company, so it is important that IFC staff meet

with those who, as a practical matter, are responsible for the principal corporate governance functions, regardless of their job titles.

1. Representatives of controlling shareholders
2. Representatives of other holders of significant blocks of shares
3. Formal or informal advisors to the owners and managers of the company, including Advisory Board Members, if applicable
4. Chair and members of the board of directors, including any "independent" board members, outside or non-family members of the Board of Directors and the chairs of the audit and other special committees of the board (and where applicable, members of the inspection committee: the fiscal board, *commisaire*, audit commission, *comisario*, or *revisor fiscal*)
5. Chief executive officer
6. Chief financial officer (or senior accounting officer)
7. General counsel (or senior lawyer)
8. Corporate secretary
9. Chief of internal audit and internal controls, if applicable
10. Chief of investor relations
11. Independent external auditors
12. Sustainability officer

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