Corporate Governance for small business
Corporate governance: Best practices for small businesses

Talk of corporate governance is not exactly common in the small business setting. After all, the term “corporate governance” refers specifically to large, publicly owned and traded companies—companies that are required by law to manage and disclose how board members and executives make decisions.\(^1\)

Essentially, corporate governance exists to ensure that companies operate in a fair, equitable and appropriate manner for the benefit of all stakeholders. To do so means to establish a set of internal policies, rules and procedures that cover topics from pay and benefits to financial reporting and everything in between.\(^2\) In a free-market business culture, corporate governance practices can bring stability to markets, strengthen institutions, promote investment and weaken corruption.

It’s true that most small businesses are more concerned about viability and affordable business solutions than they are about corruption. And while most small businesses typically don’t have a board of directors, they do have investors or multiple business partners with a substantial interest in the success and growth of the company.

In this sense, talk of corporate governance in the small business setting makes sense. Following the best practices that many large businesses have established through corporate governance, small businesses and start-ups can set out on the path to streamlined and accountable operations. It’s also a great way to set precedents for future employees and investors and preparing for growth.

Still not convinced there’s a connection? Consider the following reasons for exploring corporate governance best practices in your small business today:

1. **Ethical operations aren’t just for the Fortune 500**
   The very backbone of corporate governance is ethics—something that is of value to the consumer, whether purchasing products or services from a large corporation or a small business. In fact, a 2002 Hill and Knowlton study found that 79 percent of Americans take the ethical business practices of a company into consideration when debating a product purchase.\(^3\)

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2. **Small companies can turn into large companies**
Small businesses that institute formalized policies and procedures early in the company’s life cycle tend to encounter fewer growing pains. Especially when and if the time comes to move toward an initial public offering (IPO), small businesses following corporate governance policies and procedures will be primed legally and culturally to make a successful jump from private to public.

3. **Policies and procedures attract and retain staff**
Corporate governance practices often establish better criteria for evaluating performance and a better system of compensation that can attract and retain quality employees. Additionally, sound governance framework ensures that investors and shareholders are freed from executive and administrative duties, reducing internal conflicts of interest that result in decreased morale and trust in leadership.

4. **It’s always a good idea to protect your investment**
Policies and procedures like those established by corporate governance practices serve to dot “i”s and cross “t”s by documenting actions of partners and investors and setting precedents for the future. What’s more, a sound investment with processes like corporate governance practices in place could even attract new investors or partners should a company still wish to remain private.

5. **The law**
In following corporate governance practices, many small businesses have developed better accounting practices along with a greater understanding of laws such as Sarbanes-Oxley and the Dodd-Frank Wall Street Reform Act that stand to impact how businesses of all sizes operate in the United States today.

In this Blue Paper®, we further examine and identify the best practices of the big dogs that are most applicable in the small business setting. Read on to learn how to assess your current business practices, establish policies and procedures for ethical and accountable decision making and how to measure the impact of governance.

**Aspects of corporate governance**
Corporate governance, as mentioned, covers many distinct areas of business to establish policies and processes that protect the best interests of stakeholders.
This begs the question: Who establishes these policies and processes? The responsibility to develop a framework for corporate governance lies with each individual corporation and often changes with individual business goals and promises of customer service and investor loyalty. However, corporations are generally guided by best practices established by state and federal law as well as in some cases international law, depending on stock exchange requirements.

In the United States, most corporate governance practices are also usually based to some degree upon three documents, each with very similar guidelines: The American Bar Association’s Model Business Corporation Act, the Organisation for Economic Co-Operation and Development (OECD) Principles of Corporate Governance and the United Nations’ Guidance on Good Practices in Corporate Governance Disclosure.

These three documents in various ways, shape and address the following categories and suggest best practices for each in corporate governance:

- Establishing and disclosing company objectives
- Outlining ownership structure and ownership/shareholder rights
- Mapping board and management structure and process
- Developing processes for changes in control and transactions involving significant assets
- Developing processes for establishing pay and benefits
- Addressing foreseeable risk factors
- Establishing regular financial audits and disclosure of audit findings
- Stating financial transparency and disclosure

Each of these areas can be translated to an extent to the small business setting. Although, in some cases, connecting the dots of how to do so is far more obvious than others.

The how-to of corporate governance for small businesses

We’ve culled the data and found the top ten things your small business can do today to translate the rules of the big dogs into best practice on a smaller scale:

1. **Get informed**
   A basic knowledge of corporate governance is obviously the necessary step in mimicking the best practices of corporate governance in the small business setting. However, educating leadership and staff members on the basic principles of corporate governance can also serve to illustrate its benefits. Pair these
benefits with clear connections to why your small business has chosen to follow these best practices and your small business is likely to see a greater buy-in from staff, partners and investors.

2. **Map your business’s current structure and visualize how it will grow**

   Essentially, create an organizational chart that establishes a hierarchy and defines responsibility broadly for the purpose of visualizing not just the reporting order but the focus areas of your business, how these different focuses interact and relate to one another, and the potential threats and opportunities that could be caused by growth. Then, develop job descriptions for each stakeholder in the business. These job descriptions should serve to separate ownership from management duties in order to set precedent, establish boundaries and define responsibilities for owners, partners, investors and employees. Mapping out your small business’s structure in this way eliminates confusion and makes it easier to measure the success of individuals or potential conflicts of interest.4

   Once the structure is outlined, small businesses can take a further nod from larger corporations to illustrate how other stakeholders, both internal and external, factor into the business’s daily operations. Take a look at this sample map, created by The World Bank, below:

3. Map your businesses current internal policies and processes and formualize them

After mapping the roles and responsibilities of everyone involved in your small business, do the same with processes. Next to risk assessment and planning, which we’ll get to in a minute, this is perhaps the most time intensive aspect of establishing the groundwork for governance. Essentially, it means taking a look at all aspects of the business and developing a protocol to set precedent and streamline internal operations. From fulfilling orders, to answering customer concerns to contingency planning to media relations and human resources—this means everything. Who decides when it’s time to hire? What is the protocol for hiring? Who responds to media inquiries? What happens if a business partner dies?

4. Establish an advisory board

“All businesses should look at their organizational structure and continually assess what will allow the company to perform in an optimal way,” says Tom Niewulis, Jr., small business consultant and blogger. “The simplest way to implement this is to have an advisory board.”

Think of the advisory board as similar to a board of directors found in larger companies and nonprofits, only one that is voluntarily established as opposed to mandated by corporate governance laws. Base your small business’s advisory board on the roles and responsibilities charged to traditional boards, such as the work depicted in this chart from the University of Nebraska Public Policy Center on basic board governance:

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The advisory board is comprised of balanced professionals dedicated to ensuring the integrity of financial data, holding executive management accountable and subsequently reducing the risks of mismanagement or conflict of interest within a small business. Because advisory boards hold no legal rights to a small business, they mainly serve as a voluntary checks and balances system that also offers insight and mentorship to small business leadership.7

When selecting individuals to serve on your small business advisory board, keep in mind the following:

- **Start with people you know and trust**—Approach mentors, former colleagues or trusted professionals with whom you have an established relationship and who will place the best interest of your small business first. Reach out to their networks or contact your local chamber of commerce to further recruit board members. Hold interviews with leadership and key investors to select the candidates that are most qualified.

- **Make the expectations clear**—Let advisory board members know what the goals of the company are and how they are expected to fit in to that big picture. Share with them the organizational chart developed earlier to help illustrate this relationship and the responsibilities.

- **Pay competitively, in cash or in rights**—Unlike corporate boards that are usually comprised of shareholders or nonprofit boards that are usually comprised of voluntary community members with the ability to give donations or hours of their time, small business advisory boards often receive monetary compensation for their services as a value proposition.

- **Know the ethical implications**—Just as in corporate governance for large businesses, small businesses looking to follow corporate governance best practices should be aware of conflicts of interest and rights of parties involved.

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5. **Introduce a code of conduct**

Much like an organizational chart can illustrate to employees the boundaries of responsibility, a code of conduct can illustrate the boundaries of their work and attitudes of such. Codes of conduct usually describe the required behaviors, responsibilities, actions or attitudes employees should have in an organization. This conduct policy ensures all individuals are on the same page and have a clear understanding of the business’ mission statement and values. This policy can also provide guidance on how employees should act or react in various business situations. Conduct policies may also include information on disciplining employees who fail to follow company guidelines.\(^8\)

6. **Set goals and develop a strategy to meet these goals**

If your small business has yet to develop a business plan in writing, now is the time to do so. “The focal point of corporate governance within small businesses is that all businesses need to set company strategic goals, provide the leadership to put them into effect, supervise the management of the business, and report on stewardship of stockholders and investors,” explains Niewulis.\(^9\) Having written goals and plans in place give direction to businesses while forcing all employees to work toward a desired outcome and face consequences when that outcome is not achieved.

7. **Make a plan for consistent financial reporting**

Many small businesses only conduct audits if, well, if they are audited for tax reasons. Alternatively, all large corporations and nonprofit organizations are required as best practice to conduct third-party audits on a yearly basis in order to report to stakeholders unbiased and accurate financial status reports. While some small businesses are a one to two person show, laying out a plan for consistent financial reporting—whether that be by an auditor or an internal process of bookkeeping—not only protects the financial investment of the organization by closely monitoring when, where and how money is being spent or allocated, but it again serves to hold staff accountable for actions while promoting transparency in operations. Both key tenants of corporate governance.

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8. Make a plan for the unexpected
More about good business than just about good corporate governance, having plans in place for how to handle the unexpected protects the investment of your small business and reduces confusion and response time if such things should occur. The old adage may be to have a back-up plan for failure, be sure to also have a back-up plan for success—in the age of social media and instantaneous communication, a small business can unwittingly go big overnight. Do you have a protocol in place to accommodate large jumps in website traffic? Large orders? An influx of phone calls or media inquiries?

9. Address compensation and benefits
Large corporations are required to approach compensation of c-suite executives extremely carefully. Federal laws such as Sarbanes-Oxley and the Dodd-Frank Wall Street Reform act restrict how and when executives may be compensated as well as what needs to be disclosed to stakeholders and when. The main purpose being transparency and fairness. While it is not be necessary for small business executives to report their earnings, there should still be protocol in place for determining how all staff—not just owners or partners—should be compensated and what benefits will be allowed to all employees.

10. Stay in the know of industry trends and governance laws
Lastly, keeping abreast of information regarding how other businesses—large and small—approach governance in your industry will hold your small business on par with best practices. Paying attention to changing laws will also prime your small business to stay ahead of the game in acting fairly and ethically.

Measuring the impact
Generally speaking, corporate governance is inherently difficult to measure, particularly in the case of small businesses. Large corporations measure the effectiveness of corporate governance in relation to laws, risk assessment, board involvement and shareholder satisfaction. Because small businesses that choose to adopt corporate governance best practices are opting into a culture of transparency and fairness for much different reasons, it only makes sense that the measurement differs as well.

Measuring the impact in the small business setting can begin with regular surveys of employees and investors as well as annual reviews of employees and owners or
partners. Additionally, surveys of other stakeholders and their views on the ethical and transparent operations of your small business can also serve as indicators of impact, as can the bottom line that is directly affected by the streamlined processes that occur with good governance.

**Mindful business**

Whether looking to expand from small business to large, preparing for an IPO or just simply looking for a proven way to conduct business ethically, transparently and fairly, following corporate governance best practices may be just the thing. Take a cue from big business and get started today.