IMPORTANCE OF CORPORATE GOVERNANCE FOR SMES

There are several definitions for corporate governance. However, the most appropriate definition which is more relevant to small and medium size enterprises (SMEs) describes corporate governance as "a set of rules, regulations and structures which aim to achieve optimum performance by implementing appropriate effective methods in order to achieve the corporate objectives". In other words, corporate governance refers to internal disciplines or systems, which govern the relationships among 'key players' or entities that are instrumental in the performance of the organization. Moreover, it supports the organization's sustainability on the long term and establishes responsibility and accountability.

The guidelines of corporate governance aim to achieve greater transparency, fairness and hold executive management of the organization accountable to shareholders. In doing so, corporate governance plays a pivotal role in protecting shareholders and, in the meantime, duly considers the interest of the organization at large without prejudice to employees' rights. Whilst executive management should have reasonable level of power to run the business, corporate governance ensures that such powers are set to practical dimensions in order to minimize misuse of authority to serve objectives not necessarily in the best interest of the shareholders. Therefore, it provides a framework for maximizing profits, promoting investment opportunities and eventually creating more jobs. In general, corporate governance highlights two major principles:

- Oversight and control over the executive management's performance and strategic directions.
- Accountability of the executive management to the shareholders.

For that reason the principles of corporate governance apply on those who assume the ultimate responsibility for success or failure of the organization. On the other hand, it is imperative to understand that the proper implementation of good corporate governance does not necessarily guarantee success of the organization. Meanwhile, a bad corporate governance practice is certainly a common syndrome causing failure in many organizations. It is interesting to know that a recent survey revealed that more than 48% of investors are willing to pay additional premium over stock prices for companies known to implement sound corporate governance practices as opposed to other companies which may have same level of profitability but characterized with inefficient management or a record of poor governance practices.

The misconception about SME's stems its roots from the size and contribution of this segment to the economy. The reality is today SMEs may appear small in size but likely many of them have potentials to grow and become big entities in future. Sadly, this prophecy still not well realized and as a result, implementation of good corporate governance practices continues to be ignored.

SMEs in Egypt form large segment of business activities. Generally, they take the form of private companies owned by small number of shareholders. Often have less than 100 employees. Such companies are usually family-owned run by family members where the authorities and powers are generally held by an individual normally the major shareholder. For that reason the owners commonly consider them as running their personal properties. Perhaps the question that strikes the mind of business owners and directors of small and medium size companies as well as the executive management team " why should we opt to choose to introduce new systems and internal rules which impose limits on the way we do business and our business conduct?". The answer is simply corporate governance plays a significant role for SMEs since it defines the role of shareholders as owners on the one hand, and as business managers on the other hand. This is best done through a process that spells out governance rules and guidelines.

These aim to assist all parties to understand how to manage the organization. As a result, internal conflicts would be better managed and more attention given to achieve growth objectives and support profitability. There are at least three reasons for small and medium size companies to show greater interest to implement corporate governance principles: The good governance practices pave the way to companies to grow or attract additional investors as alternative to raising capital through borrowing from banks at high cost. Additionally, companies may consider going public through IPO. Sound governance practices lead to improved internal control systems, which results in more accountability and higher profitability. The latter is attributed to enhanced controls, which minimize the likelihood for fraud losses. Corporate governance framework ensures that shareholders are freed from executive and administrative duties. As a result, conflicts among business owners who assume management roles in the organization would be reduced to a greater extent particularly in organizations owned by few numbers of shareholders where the distinction between ownership and management capacity is blurred. Raising capital has been for a long time seen as the major challenge facing SMEs. The real challenge is absence of good corporate governance practices in such organizations. Consequently, it would be difficult to access sources of finance from banks or investors. Adoption of corporate governance framework is not common not only in Egypt, but also in most developing countries. This is mainly due to lack of awareness about what corporate governance is about and its relationship with corporate performance and objectives.

Besides, the widespread fallacy that implementing corporate governance entails high costs coupled with doubts that such costs would not generate the envisaged benefits to the organization. The biggest challenge for small and medium size companies in Egypt is about how far they can cope with the external business conditions and internal problems, which threaten their ability to survive. Surveys indicate that one-third of this category of companies collapse after three years for the following reasons: Absence of planning and forward thinking Inadequate leadership and management skills at senior management level Lack of future business plans for growth and new investment plans Problems with cash flows Inability to innovate, present ideas for business development and cope with ever changing business environment and economic conditions Inadequate access to technical assistance If we consider the main reasons why small and medium size companies fail, we may conclude that implementing corporate governance contributes to a far extent to support chances for these companies to perform well, grow and adopt better process for decision making. For family owned businesses, corporate governance improves management efficiency, limits internal conflicts and helps in making transition of ownership to heirs a smooth process. Practically speaking, we need to realize that SMEs may face several problems in implementing corporate governance framework, which may often seen costly exercise. Consequently, it is essential that consideration should be given to reduce the relevant requirements for compliance and disclosure and introduce less expensive financial and administrative alternatives, which such companies can afford. In order to help small and medium size organizations to implement corporate governance, we recommend that the competent state authorities issue a code for SME's corporate governance similar to that issued by General Authority for Investment in collaboration with Cairo & Alexandria Exchange. Particular attention should be given to the following: Transparency (strategies, organization chart, processes etc.), Role of Advisory Board and relationship with other entities, Risk management system and planning, Human resources function with focus on succession plans for senior management.

Finally, we propose a short prescription to deal with the challenges and assist in implementing corporate governance framework for SMEs:

- Separate ownership from management duties and specify clear roles and responsibilities for business owners, partners and other stakeholders.
- Create a balanced board and invite non-executive directors who would add value to the board (replace the board of director with an advisory board for companies that are not legally required to establish a board of director). Non-executive directors play an important role in ensuring integrity of the financial data provided to the board and to protecting shareholders' interest. They also exercise control over executive management and reduce the risks arising from poor management practices or gross negligence.
- Introduce Code of Business Conduct.
- Raise corporate culture with a focus on benefits of corporate governance
- Develop senior management's administrative and technical skills particularly in areas such as strategic planning and leadership.
- Create clear organization charts.
- Establish independent internal audit function (or employ an internal auditor based on the size of the organization).
- Create job descriptions, which establish clear responsibilities and reporting lines.
- Introduce succession plans and rules for conflicts of interest.

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