**Manual for the Corporate Governance Toolkit for Corporates[[1]](#footnote-1)**

# Introduction

## What is Corporate Governance?

Corporate governance (CG) refers to the structures and processes for the direction and control of companies and concerns the relationship among the management, board of directors (or supervisory board), controlling shareholders, minority shareholders and other stakeholders. Good CG contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital.

## Why Corporate Governance Matters for our Investee Companies

* Access to Capital: Empirical evidence shows that well-governed companies receive higher market valuations. Improving CG structures and processes increases other capital flows to companies in developing countries from several sources including domestic and global capital; equity and debt; public securities markets and private capital.
* Improving Performance: Good CG leads to better performance for our investee companies. Improved governance structures and processes help ensure high quality decision making, encourage effective succession planning for senior management and enhance the long-term prosperity of companies, irrespective of the type of company and its sources of finance.

## Why Corporate Governance Matters for FMO

* Reducing Investment Risks. It is in the interest of FMO to reduce the risk of our investments by improving the governance of investee companies.
* Adding Value. CG is a priority for FMO because it presents opportunities to manage risks and add value to investee companies through increased performance and access to capital. FMO’s approach to corporate governance is captured in its ESG Policy.
* Developing Capital Markets. Improving CG contributes to the development of the public and private capital markets.
* Mitigating Reputational Risk. FMO assumes a reputational risk if involved with companies with poor governance and may become tainted by corporate scandals.

# Corporate Governance Toolkit

## Introduction to the Toolkit

The purpose of the Corporate Governance Toolkit for corporates (applicable to all types of companies irrespective of size or type of ownership i.e. family-owned, listed, unlisted, SME’s, etc.) is to properly assess the overall risk related to CG according to five key risk areas:

* The Commitment to Corporate Governance
* Structure and Functioning of the Board of Directors
* Control Environment and Processes
* Transparency and Disclosure
* Shareholder Rights

The process of identifying, attributing and, at times, mitigating these risks in the investment decision will be called a *Corporate Governance assessment*. The toolkit facilitates the investment teams with the assessment of the Corporate Governance structures and practices.

Every FMO investment or debt transaction needs to undergo a Corporate Governance assessment using the Toolkit referred to in this Manual, with the following limited **exceptions**:

* Start-up deals under project finance and SPVs (mainly in the Energy Department),
* Investment deals in Private Equity Funds[[2]](#footnote-2)
* Deals for which the FMO loan amount is at or under 5% of the balance sheet of the client (unless more than 4 questions have been answered with a ‘True’ in the CG CIP Questionnaire).

## Scope of Application

The Corporate Governance Toolkit for Corporates can be applied to all companies (listed or privately held) in emerging markets and includes a special section that should be applied when looking at family-owned companies. The tools were designed keeping FMO’s typical clientele in mind, thus listed companies in more developed capital markets may fall outside of its scope.

## Overview on Different Tools

The Corporate Governance Toolkit for Corporates includes four key CG tools for analyzing the governance of investee companies, namely:

1. **CIP CG Assessment Questionnaire:** This tool supports investment staff in the identification of CG risk factors and helps with deciding whether a member of the Corporate Governance Unit needs to be involved in the due diligence process. Two statements are posed under each of the five risk areas of CG (Commitment to Corporate Governance, Structure and Functioning of the Board of Directors, Control Environment and Processes, Transparency and Disclosure and Shareholders Rights) which are meant to identify the key sensitivities and/or (potential) risks at an early stage of the project. The Due Diligence should focus on obtaining a better understanding of how key governance issues are managed and handled.
2. **FP Questionnaire:** The **FP Questionnaire** is a more detailed questionnaire to be filled in by the investment team during Due Diligence. The questionnaire requires the investment team to discuss topics associated with Corporate Governance with the client and to conclude on the appropriateness of the existing structures and practices. The investment team should provide and concise (1-3 sentences) and concrete answers to all questions.

The investment team should conclude whether the company has an appropriate Corporate Governance framework. If it is not adequate (or ‘fit for purpose’), then should either the team will need to suggest the appropriate risk mitigation measures.

A brief summary of the Corporate Governance structure, summarized conclusion and prioritized CG improvements will be included in the Financial Proposal.

1. **Annex: CG Progression Matrix:** The **CG Progression matrix** lists the five risk areas of governance and describes four possible levels of achievement. The use of a matrix framework emphasizes the importance of ongoing improvements in the governance practices of investee companies, rather than trying to apply rigid and static minimum standards. It is also there to provide for an orientation to the investment staff as well as the client. The **CG Progression Matrix** helps identify potential mitigations for the risks identified rather than assessing the risk level. Investment teams are encouraged to share the progression matrix with the client to discuss their current status and ambition of where they want to be and encourage them to use it for self-evaluation.

The investment team needs to score the current state of the Corporate Governance practices based on the **CG Progression Matrix** by using their best judgement to select the maturity level (Basic, Emerging, Advanced, Developed) that best corresponds with the structures and practices of the assessed institution. The simple average of the score (automatically calculated by the template) is input for the scorecard.

# Guidelines

## The CIP CG Assessment Questionnaire

The CIP Questionnaire should be applied to all deals except:

* Start-up deals under project finance and SPVs (mainly in the Energy Department),
* Investment deals in Private Equity Funds[[3]](#footnote-3)
* Deals for which the FMO loan amount is at or under 5% of the balance sheet of the client

Two questions are posed under each of the five risk areas (Commitment to Corporate Governance, Board Structure, Control Environment, Transparency & Disclosure, Shareholder Rights). All questions need to be answered with either ‘TRUE’ or ‘FALSE’ and they are meant to be answered at early stages based on the Company’s Annual Report, Website and/or initial high-level discussions.

The questions in the **CIP CG Assessment Questionnaire** relate to prioritized risk factors. The **CIP CG Assessment Questionnaire** provides input and direction for the Due Diligence. Specific research during the Due Diligence phase is required if the answer to a question is ‘TRUE’. After the Due Diligence it should be clear whether the Corporate Governance practices are adequate given the characteristics of the company and whether specific risk factors are adequately addressed.

The **CIP CG Assessment Questionnaire** should help the investment team focus its forthcoming due diligence on the key CG risk factors. It also has a direct implication at the CIP stage. While the CG Unit can be consulted at any stage of the process, if and when **four (4)** or more questions are answered with ‘TRUE’, the investment team must consult the CG Officer/Analyst. Depending on the outcome of the consultation, the decision may be to include the CG Officer as part of the project team. In case of the CG Officer's involvement, the deliverable at FP stage is his or her direct responsibility.

**Calculating the CG Score to input in the Scorecard at CIP stage**

The score can be calculated by obtaining the **average** of the values of all 10 questions contained in the CIP Questionnaire.

## The FP questionnaire

The **FP questionnaire** provides a number of open and closed questions that need to be answered by the investment team as part of the Due Diligence. The questions relate to the five risk areas (Commitment to Corporate Governance, Board structure, Control environment, Transparency & disclosure, Shareholder rights).

As an outcome of the due diligence - supported by the **CG Questionnaire**, **CG Progression Matrix** and **FP questionnaire** - the investment team should draft a conclusion on the Corporate Governance practices of the client. In case that the CG Officer has been involved, it is the latter's responsibility to complete the questionnaire and to provide a conclusion.

The investment team should determine whether:

* The Corporate Governance practices are adequate for the specific corporate given the company characteristics, risk profile and complexity
* There are any required Corporate Governance mitigating activities that need to be included:
  + Individual action items
  + Corporate Governance action plan
  + Detailed Corporate Governance review to be performed by the CG Officer

## Who to interview during due diligence for to obtain a better view on Corporate Governance?

The list of the key individuals who are in the best position to provide insights into the Corporate Governance structures and processes of the company are listed below. Investment teams typically already meet with most of these individuals as part of the due diligence process. Adding the Corporate Governance layer represents mostly incorporating specific questions into the conversation, most of these questions appear in the FP Questionnaire template described above.

If and when a CG Officer conducts a CG Review, he or she interviews all Board Members and all shareholders. The investment team is not required to do this in their normal review process, but as a minimum, they should meet add at least one more interview that may normally not part of the regular DD, which would be with a member of Board of Directors or Supervisory Board, ideally an independent director (if there is one) or a non-executive Director. This conversation will help get a better view of the structure and functioning of the Board and the overall decision process. A more complete list of the key individuals that are able to provide insights into CG practices and structures appears below:

* Representatives of controlling shareholders
* Minority Shareholders (especially if there are any with past or current disputes with the Company)
* Chairperson and members of the Board of Directors, including independent Board members and the Chairs of Board Committees if there is one (especially Audit Committee)
* Chief Executive Officer
* Chief Financial Officer (or senior accounting officer)
* Corporate Secretary and/or Chief of Investor Relations
* Chief of the Internal Audit function or internal auditor or individual who conducts this function.
* External Auditors

IN the final conclusion section of the FP Questionnaire, the investment team may either suggest risk mitigation for identified risks or additional steps needed to be taken to eventually mitigate the CG risks identified (such as involvement of the CG Officer, a CG consultant, etc.). At times, the investment team may decide to acceptance of existing risks. If and when teams identify openness from the owners and or Management to improve CG Practices, they are encouraged to offer support in this regard as it is a crucial opportunity to add value.

## The CG Progression Matrix

The **CG Progression matrix** relates the five risk areas of governance to four levels of achievement and should be used during due diligence phase together with the questionnaire. The use of a matrix framework emphasizes the importance of ongoing improvements in the governance practices of investee companies, rather than trying to apply rigid and static minimum standards. It is there to provide an orientation to the investment staff as well as the client.

The first level of the matrix represents the basic governance practices that investee companies might have in place. The next three levels describe more advanced practices towards which investee companies may gradually progress, which increase in relevance as companies grow and become more complex.

The investment team needs to score the current state of the Corporate Governance practices based on the progression matrix. The investment team should use their judgement and select the maturity level (Basic, Emerging, Developed, Advanced) that best corresponds with the structures and practices of the assessed institution. The average score is input for the **Scorecard.**

The investment staff needs to consider the overall size, industry and growth trajectory of the Corporate among other factors to make this final judgment.

# Quick reference card – Revised CG toolkit FIs

**FP**

**Due Diligence**

**Tool:**

* **CIP CG Assessment Questionnaire**

**Output:**

* **Completed CIP CG Assessment Questionnaire**
* Insight in risk factors to be addressed in detail during DD
* Decision on whether to involve the CG Officer

**Tools:**

* **FP Questionnaire**
* **CG Progression Matrix**
* **CG Assessment Questionnaire**

**Tools:**

* **FP Questionnaire**
* **CG Progression Matrix**

**Output:**

* Completed **FP Questionnaire** as annex to the FP
* Summarized description of CG structure
* Summarized conclusion on appropriateness of CG
* Overview of mitigating measures (if any)
* Scoring of Corporate Governance structures & practices based on the CG Progression Matrix

**Summarized guidelines:**

* **CIP CG Assessment Questionnaire** to be completed for every client/opportunity
* **CIP CG Assessment Questionnaire** provides direction for DD (i.e. identified risk factors)
* Contact CG officer if more than 4 out of the 10 questions are answered with a ‘True’

**Summarized guidelines:**

* Allocate time for the CG assessment during DDS (i.e. meeting with Independent or External Director, CEO and head of IA)
* Tools help to structure the discussion on Corporate Governance
* Discussion/interviews should provide more insights in actual working practices (instead of focusing on CG paper).

**Summarized guidelines:**

* Responsibility of the Corporate Governance Officer if involved
* The CG practices are scored on the basis of the progression matrix, the maturity level that best reflects the current CG practices is selected.
* Mitigating activities are defined in case there are any required improvements or in case there is an opportunity for FMO to add value
* Questions applicable to ‘Family-owned’ should be used when dealing with such companies.

**CIP**

1. This toolkit referred to in this Manual is used for all FMO Investments and Loan into Corporates and is useful to assess governance of companies irrespective of the type of ownership (privately-held, family-owned, public companies) and irrespective of size (SME, large company) or the industry in which they operate. [↑](#footnote-ref-1)
2. The CG Toolkit for Corporates is not designed to assess Fund Governance. For this case, the CIP and FP Templates check for alignment with ILPA Principles. The toolkit is however useful for PE Fund Managers to assess CG of investee companies and can be shared for this purpose accordingly. [↑](#footnote-ref-2)
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