



Review Of The Small And Medium Scale Enterprises (SME) Corporate Governance Guidelines 2023

INTRODUCTION

The Financial Reporting Council of Nigeria (FRCN) on May 30, 2024 launched the **SME Corporate Governance Guidelines 2023 ("The Guidelines")**. The Guidelines seek to streamline and adapt the Nigeria Code of Corporate Governance (NCCG) to cater to the specific needs of Micro, Small, and Medium Enterprises (MSMEs), which represent 96% of all businesses in Nigeria, account for 84% of national employment, and represent 48% of Nigeria's GDP. The objectives of the Guidelines are to improve Nigeria's business environment and increase the longevity and sustainability of Micro, Small, and Medium Enterprises (MSMEs) while increasing business confidence and access to capital and trade for adhering entities. This paper aims to comprehensively review the key provisions within the Guidelines, explaining their implications and offering practical steps for Nigerian SMEs to implement them.

According to the National Policy on SMEs issued by the Small & Medium Enterprises Development Agency of Nigeria (SMEDAN), an SME is defined by the following characteristics:

SIZE CATEGORY	SIZE CATEGORY	ASSETS (N million) (excluding land and buildings)
Micro Enterprise	Less than 10	Less than 5
Small Enterprise	10 - 49	5 - less than 50
Medium Enterprise	50 -199	50 – less than 500

The Guidelines aim to improve Nigeria's business environment and enhance the longevity and sustainability of SMEs. By adopting good corporate governance practices, SMEs can achieve several key benefits:

Robust Business Processes:

Strong corporate governance helps establish clear structures and procedures, leading to more efficient operations.

Preparation for Growth:

Good governance practices pave the way for future expansion by fostering transparency and accountability.

Enhanced Attractiveness:

Implementing these guidelines can make SMEs more "bankable" and attract investment opportunities.

Improved Stakeholder Relationships:

Transparency and accountability build trust with stakeholders, leading to stronger relationships.

Long-term Sustainability:

Good corporate governance sets the foundation for responsible and sustainable business practices

The Guidelines consists of seven (7) sections and outlines ten (10) core principles. These principles apply to all Micro, Small, and Medium Enterprises operating in Nigeria, with the effective date to be determined by the FRCN.

Highlights of the Guidelines

Corporate Governance Policies & Procedures

- The Guidelines recommend the adoption of a formal corporate governance framework detailing the roles of the key stakeholders such as partners, shareholders, Board of Directors, and management.
- A written document should outline the delegation of authority and clearly define management roles and board/shareholder reserved matters.
- A formal succession plan with clear steps for both planned and unplanned leadership transitions should be developed.
- As part of succession planning, SMEs should create a skills matrix to assess existing skills and identify gaps. SMEs should also ensure the provision of training and development opportunities to address skill gaps and prepare for future leadership roles.

Stakeholder Engagement

- SMEs should recognize the needs of their stakeholders. They should formulate policies outlining their values and objectives in relation to all areas of stakeholder engagement.
- Targets relating to the management of stakeholder relationships should be set and progress against the targets should be monitored and measured.

Family-Run Entities

- SMEs should develop a framework setting out the family's relationship with the business. Clear lines of authority and decision-making, policies on employing family members, and clarifying the separation of the family business and family affairs should be developed.
- A Family Governance structure should establish written procedures to facilitate effective coordination and communication between family members and the other stakeholders of the business.

Board of Directors

- SMEs are encouraged to set up a formal Board of Directors to complement the growth of the entity. The size of the entity should determine the appropriate number of members, but good practice for SMEs would be between five and ten members.
- The Board should adopt formal procedures for board meetings, including working through a formal agenda, addressing strategic as opposed to more operational issues, and ensuring that minutes taken include all items discussed and resolutions adopted.
- Smaller SMEs should consider an advisory board of 2-3 members with expertise and networks to support the business without formal decision-making power.
- SMEs looking for strategic advice are encouraged to consider Independent Non-Executive Directors for the Board as they bring objectivity and expertise to the Board.
- SMEs should provide a tailored induction process for all directors. The induction process should include meeting major shareholders, senior and middle management and visiting sites where applicable.
- SMEs should have a board charter and a statement of reserved matters and powers for the Board. The board charter should clearly express the role and fiduciary duties of the Board and include values and principles such as good faith, anti-corruption, etc.
- The Board should be supplied promptly with information in a form and of a quality appropriate to enable it to discharge its duties.
- The Board should meet as frequently as necessary for the discharge of its obligations.
- The Board should undergo a regular performance evaluation process which includes a review of the composition of the Board.
- For the Board oversight over management to be truly effective Medium-sized Entities should consider separating the functions of the Chairman and the Chief Executive Officer.

Control Environment

- SMEs should maintain accurate and reliable books of accounts reflecting the true and fair view of financial performance, prepared in accordance with FRCN's financial reporting framework.
- Medium-sized entities should prepare complete financial statements. Any changes in accounting policies should be disclosed and justified in the financial statements. They should utilize a reputable independent auditor to audit the financial statements. Micro and Small entities can prepare statements for operations and do not require external audits unless mandated by law.
- Medium-sized Entities should formally evaluate the effectiveness of the external auditor and formulate policies to preserve the independence of both the internal and external audit function.
- Management, with the approval of the Board, should establish an IT Governance framework that is communicated in simple and clear language to all employees and integrated into the business's day-to-day operations, with clear guidelines and standards for managing key risks.
- Medium-sized Entities with complex operations should conduct annual IT risk assessments led by a qualified professional, ensuring mitigation strategies are in place.
- SMEs should adopt an appropriate internal control framework that considers the business's size and complexity and apply that framework consistently and effectively. Also, they should document a formal process for identifying significant business risks and management should adopt formal control mechanisms.
- More developed SMEs should set up a specialized board-level committee (risk management committee) to monitor the entity's overall control environment.
- SMEs should consider establishing an Internal Audit function. The Internal Audit unit's primary role should be ensuring that the risk management approach is being implemented throughout the entity, and that suitable internal controls are set and are operating effectively.

Environmental, Social and Governance (ESG) Considerations

- SMEs should consider environmental and social responsibility in their operations.
- SMEs should maintain the highest standards of governance, which are systematically reviewed and improved to comply with regulatory expectations.
- SMEs should commit to relevant best practice standards and initiatives to build their capacity and demonstrate their commitment to ESG.

Transparency and Shareholder Relations

- SMEs should establish a timely, open, and transparent flow of information with investors and shareholders. All shareholders should be treated equitably, and clear lines of communication should be established with investors.
- An effective engagement mechanism should be established to gauge the views of shareholders. Medium-sized Entities should hold Annual General Meetings (AGMs) with comprehensive minutes of meeting reflecting discussions and voting results.
- There should be full and comprehensive disclosure of all matters material to investors and stakeholders. The Board should ensure that the company's annual report includes a corporate governance report that provides clear information on the company's governance structure, policies, practices, environmental/social risks and opportunities.
- The annual report of the SME should contain a Board statement on the company's ESG activities. The appropriate Board committee should review this and may be subjected to independent review.
- The company should establish policies and procedures for identifying, communicating, and responding to stakeholders' concerns.

Conclusion

The Guidelines serve as a valuable framework for Nigerian SMEs to strengthen their corporate governance practices. By embracing these recommendations, SMEs can achieve greater transparency, accountability, and overall business success. This will ultimately attract investment, improve stakeholder relationships, and contribute to long-term sustainability.

Disclaimer

This paper is intended for informational purposes only and should not be construed as legal or financial advice. It is recommended that SMEs seek professional guidance for complex governance matters.

For recommended practice and formulation of board policy documents to align with the provision of the code, please contact the Society for Corporate Governance via email – info@corpgovnigeria.org

