

**Institute for Governance  
of Private and Public Organizations**

Report of the

**Working Group on  
Small and medium-sized businesses Governance**

**"Building Better Business"**

May 2008

## MESSAGE FROM THE CHAIR OF THE BOARD OF DIRECTORS

### INSTITUTE FOR GOVERNANCE OF PRIVATE AND PUBLIC ORGANIZATIONS

---

In keeping with its mission to contribute to the improvement of governance in the private and public sectors in Quebec, the Institute for Governance of Private and Public Organizations has set up working groups to look into governance among universities and healthcare institutions and has issued a number of reports and recommendations in this regard.

The goal with this Working Group has been to examine governance issues specific to small and medium-sized businesses. SMBs are the backbone of our economy and a major driver of industry growth. But our SMBs are up against some considerable challenges in these turbulent times marked by a profound shift in the global economy.

We feel that governance models adapted specifically to the needs of SMBs and their owners and managers would be an invaluable asset. One of the competitive advantages of Quebec companies is the extensive experience and skills that have been developed since the 1960s. Our SMBs – the major players of tomorrow – can tap into this to support their management and decision-making needs.

We have to find ways of matching up this wealth of expertise with the dynamic spirit of today's entrepreneurs so that our entire society can benefit. This would give a positive spin and concrete meaning to the abstract and often misinterpreted notion of "governance" at the SMB level.

We are delighted that such a highly qualified group of people accepted to take part in this Working Group and provide their insight into these matters. I extend my sincere thanks to them and to Michel Audet who chaired the Group with exemplary efficiency.

The IGPPPO is committed to implementing the Working Group's recommendations and setting up training programs aimed at managers, advisory board members and directors of

SMBs. The Institute also supports the idea of having the Working Group follow up on these recommendations and track the progress made over the coming year.

A handwritten signature in black ink, appearing to read 'Yvan Allaire', written in a cursive style with a long horizontal stroke at the end.

**Yvan Allaire, Ph.D., FRSC**  
Chair of the Board of Directors  
Institute for Governance of Private and Public Organizations

## MESSAGE FROM THE CHAIR OF THE WORKING GROUP

---

The Working Group that I have had the pleasure of chairing was created at the initiative of the Institute for Governance of Private and Public Organizations. The Group is made up of representatives from leading organizations involved in the support and development of businesses in Quebec, especially small and medium-sized enterprises which form the backbone of our economy.

Among the members of the Group were the President and CEO of the Fédération des chambres de commerce du Québec; the President and CEO of the Board of Trade of Metropolitan Montreal; the Vice-President, Quebec, of the Canadian Federation of Independent Business; the President of Quebec Manufacturers & Exporters; and the Executive Vice-President of the Groupement des chefs d'entreprise du Québec. The Group also benefited from the presence of representatives of several institutional investors that work closely with SMBs. It was rounded out by several other respected members of the business community.

We were fortunate to be able to tap into the in-depth knowledge of the members of the Working Group with respect to issues specific to SMBs and take advantage of their close ties with a number of key players in this sector. I thank all of the members for their cooperation, their input and the many contributions of their respective organizations.

I would like to extend special thanks to the Ministère du Développement Économique, de l'Innovation et de l'Exportation for the support services they provided. We are particularly grateful to Sophie de Courval and Hélène Lafrance for their assistance and cooperation. The Group also received the unconditional support of the IGPPPO and HEC Montréal. We would also like to acknowledge the efforts of Michel Lord, who played an active role in the Group's activities and in the editing of this report.

Finally, I would like to recognize the contributions of numerous SMB owners and managers, in particular those who took part in the forum on February 26, 2008. Their

candid responses to our questions and comments on governance heavily influenced the proposals contained in this report. That is why we have included comments from this activity in the appendices of this report.

In conclusion, I would like to express my hope that the suggestions and recommendations made by the Working Group will prompt today's SMB leaders to reflect on governance issues within their own organizations. In my view, this report is not the end of a process, but the beginning of a new approach that will help shape the long-term success of our businesses.



Michel Audet  
Chair of the Working Group

## RECOMMENDATIONS

---

In light of previous findings and observations, the Working Group came up with a series of recommendations designed to improve the quality of governance and promote the adoption of new governance measures by Quebec SMBs.

### **Recommendation #1**

**Once their companies reach a certain size and level of complexity, owners and managers of SMBs should consult regularly with an advisory board to support their decision-making and business development efforts.**

The Working Group proposes the advisory board as a governance structure adapted to the needs of most SMBs, especially in cases where an executive or an executive's family is the sole or predominant shareholder. For most SMBs, a board of directors is a heavy burden and requires a degree of formality that may turn away potential advisors and directors.

The membership and operation of the advisory board must, however, be based on principles that reinforce quality governance.

**Membership:** Ideally, the advisory board should be made up of three or four outside members, along with the main officer of the company and shareholder and the organization's senior executives. External advisors should be considered to be "independent," i.e., not compensated by the organization other than for their involvement in the advisory board. They should be able to express an unbiased point of view and be prepared to contribute their time and knowledge to the organization.

**Tasks and responsibilities:** The members of the advisory board must have a good understanding of the company in order to engage in productive discussions about the overall directions it takes and the strategic issues it faces. Members ensure that they obtain and review reliable financial information and details regarding major investment proposals. They advise on compensation and appraisal policies for senior executives. The advisory board meets five to six times a year, with more regular and frequent contact with

management during the year to ensure a good grasp of the sector, market trends and the company's development. Although advisory board members do not have the same legal obligations as directors, it is still preferable to make sure they are covered by liability insurance to protect them from any claims against company officers and directors.

**Compensation:** External advisory board members should receive a modest, yet meaningful, monetary compensation from the company. Almost all of the business leaders polled by the Working Group agreed with this proposal, as they felt the resulting benefits for the company far outweighed the corresponding costs. All in all, an advisory board provides access to high-level expertise at a relatively low cost.

### **Recommendation #2**

**The management of a small or medium-sized business with a significant portion of its capital held by shareholders other than the controlling shareholder should establish a formal board of directors that adheres to strict governance principles and rules.**

A board of directors of this type composed of a sufficient number of outside, "independent" members not only fulfills a fiduciary role and protects shareholders' interests but also contributes to creating value from an economic and social perspective. The board is separate from the management committee or team, which is made up of the company's senior executives, and replaces the board of directors established under the *Companies Act*.

In many cases, companies are major employers in a given community and therefore have a direct influence over its welfare. The responsibility of these SMBs and their boards of directors goes beyond the creation of wealth for their shareholders. They are also bound to contribute to the well-being of their employees and the community as a whole.

Small and medium-sized business owners must take a proactive stance when it comes to establishing a board of directors rather than a reactive one. If they decide to sell part or all of their company to their management team, for example, they may decide to maintain a portion of their ownership interest and continue to play an active role on the board of

directors. It is more frequent for a board of directors to be created when a financial institution or venture capital fund acquires an interest in the company. In this case, it is in the interest of the management team to be well versed in the operating principles and rules of a board of directors in order to play an active, informed role in its creation.

### **Recommendation #3**

**Institutional investors should adhere to a set of “best practices” with regard to the governance of the SMBs with which they join forces.**

In Quebec, many SMBs are backed by institutional venture capital investors, which as a result have a major say in the governance models that are put into practice. Some investors require a board of directors to be set up and appoint representatives in an oversight capacity rather than one aimed at creating value, without consulting company executives to determine what kind of expertise would be the most advantageous. The institutional investors interviewed admit that these practices often yield poor results and need to be overhauled.

Ideally, major institutional investors should share their experiences and join forces to establish a code of best practices in terms of the governance of SMBs. This code could, for example, recognize the advisory board as a governance structure that would be advisable for many small and medium-sized companies. The formation of a board of directors would be particularly useful in the case of higher-risk startups or companies in which shareholders or investors play a large part.

As the head of one of these institutions interviewed so aptly put it, “encouraging rather than imposing governance” is the path to a successful partnership.

### **Recommendation #4**

**The heads of non-listed companies that have implemented a successful governance structure should act as ambassadors of good governance.**

SMB owners and managers who have seen the benefits of good governance first hand are the most effective advocates for spreading the word to their fellow executives. Those with whom we met confirm that they would be willing to share their experience and even help other businesses set up their own governance structures.



The success of the Groupement des chefs d'entreprise confirms that many SMB owners are happy to share their experiences. The organization's approach could serve as the basis for a model of distributing effective governance strategies for SMBs.

Specialized trade publications are encouraged to shine the spotlight on these experiences and governance practices used in the SMB community. Similarly, it would be advantageous for business associations, chambers of commerce and other organizations and stakeholders to work with SMB executives to publicize their forums devoted to good governance.

Two questionnaires (see Appendix D) are available to allow organizations to poll SMBs about the formation of advisory boards and boards of directors.

**Recommendation #5**

**The government should avoid stepping in to structure or impose governance rules in the case of non-listed companies.**

The *Companies Act* and the *Securities Act* Already set out a number of obligations for incorporated companies as well as restrictions on the promotion and sale of shares. In revised version of these statutes, the Working Group recommends that the Quebec government strive to facilitate good governance through incentives rather than imposing a new set of restrictions on SMBs.

Through ministries and organizations involved in economic development, governments can promote effective governance among SMBs. These agencies include the Ministère du Développement économique, de l'Innovation et de l'Exportation, Investissement Québec, the Business Development Bank of Canada and the Caisse de dépôt et placement du Québec, all of which work closely with Quebec SMBs and can therefore contribute to this process in their own way.

### **Recommendation #6**

**A concrete action plan to promote and improve the governance of SMBs should be developed and the mandate of the Working Group should be extended by a year to ensure its implementation and monitoring.**

The mandate of the Working Group was to propose concrete solutions for improving governance among SMBs. In order for this objective to be fulfilled, an action plan must be formulated involving all of the stakeholders engaged in the first phase of the process. The Working Group maintains that, for governance principles and rules to be sustainably implemented in the largest possible number of SMBs, ongoing communication and training efforts directed at SMB owners and managers are essential.

The Working Group applauds the IGPPO's initiative to implement governance training programs specifically for SMB owners and managers. The response to these programs adapted to their needs and availability has been very enthusiastic.

There are many documents, training programs and tools available throughout the province on the issue of good corporate governance. One of the first priorities for the Working Group will be to establish a complete inventory of the available materials.

The Group will then bring together the various stakeholders involved in the SMB sector – associations, financial institutions and various public- and private-sector organizations – in order to determine the roles of each within the framework of a solid action plan. The elements of the plan, including the commitments and responsibilities of each stakeholder, and a specific timeframe will be clearly established.

This action plan will be presented in fall 2008 during a conference on governance organized by the Institute for Governance of Private and Public Organizations. In spring 2009, the Working Group will release a report on the results of this initiative.