Strengthening SMEs

A Guide to Business Management and Governance for Small and Medium Enterprises in East Africa

Wanjohi Ndagu & Richard Obuobi

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Reviews

The need for good governance is no longer the preserve of listed companies because proper management and governance are very important components of success for all businesses. Today’s SMEs are the economic leaders of tomorrow, provided they embrace best business practices, so that real transformation can be realised in our economies. This guide presents the fundamental practices that an SME needs to employ in order to attain sustainable growth. It is my hope that the Ugandan business community will develop a deeper appreciation of good business governance practices to deliver the desired change.

Sam F Owori
CEO, Institute of Corporate Governance of Uganda

The Kenyan SME sector is going through a transformation; businesses are venturing into new markets at a fast rate. Management infrastructure and governance systems, therefore, have to keep up with the pace and support these changes. Business systems, like many other facets of life in Kenya, are always catching up, so this guide is both relevant and timely.

Carole Kariuki
CEO, Kenya Private Sector Alliance

As a believer and promoter of best business practices, I think this guide is a great tool for SMEs. Businesses need to plan for the future; having the right supporting structures is critical to that.

Dr Evans Rweikiza
Executive Director, Tanzania Private Sector Foundation
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Preface

Most small and medium enterprise (SME) owners across the world consider business management and governance systems (or corporate governance) as an issue relevant only to large companies. In many African countries, the concept is still new and unfamiliar even to some big companies. African Agricultural Capital (AAC) and Netherlands Development Organisation (SNV), though, see it as important to the development of SMEs in the East African region.

When we searched for existing SME-friendly resources on corporate governance, we discovered that the only available materials and training programmes were more appropriate for larger corporations and/or developed-world contexts. They did not meet the unique needs and challenges of SMEs in the African context. AAC and SNV then decided to create this guide specifically for SME owners, to promote best practices in business management and governance among them.

In this guide, we endorse management and governance systems as a key ingredient for a successful and stable business. We encourage SMEs to establish appropriate systems and to avoid the common ‘one-man show’ approach among them. We show them the relative ease of achieving such a positive development just by making a few changes in how they manage their businesses. To help them, we present best practices and benefits of proper management and governance systems, along with business case studies about their fellow SMEs that have successfully applied them.

As part of our preparation for this book, we did a baseline survey to determine the acceptability and implementation of proper business management and governance. The study included 111 SMEs from Kenya, Tanzania, and Uganda. We discuss the results in the introduction.
In the end, we hope that this guide accomplishes the reason for which it was written: to strengthen SMEs in the East African region.

*Wanjohi Ndagu and Richard Obuobi*
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We also thank the SMEs that allowed us to use details of their best management and governance practices: Eldoville Farm, Lachlan Agriculture, and Stantech Motors, in Kenya; Buturi Investments Limited, Lahamat Limited, and Universal Group Limited, in Tanzania; and Good African, Micro Enterprise Development Network, and Uganda National Agro-Input Dealers’ Association, in Uganda.

We offer our gratitude to Tom Adlam, AAC managing director, and Reuben Coffie, SNV senior regional investment advisor of East and Southern Africa, who provided valuable guidance and support to this book project. We are also grateful to Seungchul Seo, for his involvement in the initial stages of the work.

Finally, we thank Agatha Verdadero, managing editor of Master Publishing, whose company provided editing and design services; Jennifer Patricia A Cariño for the cover design and inside layout; Waweru Ndagu of Original Images, for the cover and inside photos; and all field staff who assisted with interviews and data collection.
Foreword

The SME sector in East Africa and Africa in general has undergone tremendous transformation over the years. It has been my great source of gratification and pride to witness and be part of this process. The business environment has improved significantly and, in the process, unlocked the great potential of the business community. As the East African common market is put into operation, business opportunities are likely to follow. In all this, SMEs stand to benefit immensely.

In my extensive work with businesses, and with SMEs in particular, I have noted the need for strengthening management and governance systems. It is important for a business to demonstrate that it is professionally run in order to access credit and gain the confidence of its diverse stakeholders. Past performance and business practices are key factors in measuring risk by financiers. Financiers will view a business more favourably if it has a track record of having systems and controls, such as those addressed in this guide.

SMEs should start setting up these systems early in their lives, so that these become part of the company culture. Simple things like budgeting, preparing management accounts, and holding regular and structured board meetings have the potential of significantly improving a company’s efficiency.

SMEs should anticipate growth and change early by equipping themselves with some of the fundamental practices detailed in this guide. Systems and proper management and succession structures should form the backbone of organisations.

I am delighted to have been invited to provide a foreword for this guide. I am a firm believer in the immense value that SMEs can bring to the growth and development of our economies and people, if properly nurtured.

Martin Oduor-Otieno
Chief Executive, Kenya Commercial Bank Group
Nairobi, Kenya • September 2010
Strengthening SMEs
Introduction

Better-governed companies have less management problems. They act on and recover from shocks more quickly, so they achieve faster and more reliable growth. Still, most SME owners across the world consider corporate governance relevant only to large companies. It is more prevalent in Africa, where the concept is still unfamiliar even to relatively large SMEs.

All businesses, regardless of size or nature, have systems of management and governance. How much business owners implement them is influenced by culture, education, type of business, business environment, and other similar factors. In the end, SME owners agree on their need for systems because they need a method to the management of their businesses, if they are to achieve their goals.

Business management and governance systems in East Africa and the rest of the continent have been in existence for a long time now. Some of the most progressive and observed ones are in land ownership and transfer. The main difference between old and current systems is the increased importance of written records. In the last 20 years, technology has had an increasingly significant impact on management and governance. Businesses in East Africa have come a long way since pre-colonial days, when transactions were rare. Today, average businesses transact multiple times daily, which make it necessary to create better management and governance systems to keep up accurately with business activities.

Until recent decades, most East African SMEs were limited in growth due to lack of systems. Traditionally, SME owners expanded only up to a size that they could still personally and actively manage on a daily basis. Nowadays, though, SMEs develop at a fast rate in the form of branches, franchises, partnerships, etc. The integration of the East African Community into a common market also presents new
openings for them in the form of regional expansion for their businesses.

Big corporations have a much deeper appreciation for proper management and governance systems because they consider them very important to their success. It is no wonder that they can explore opportunities in one corner of the world and manage them from another. SMEs should have the same attitude towards business management and governance systems in order to develop themselves.

**A Definition of Business Management and Governance**

For the purpose of this guide, we will refer to “corporate governance” as “business management and governance systems” (and other derived phrases) because SMEs generally do not consider themselves ‘corporate’. However, the meaning remains the same: It is the method by which companies, big and small, are run and kept in check.

**Survey on Management and Governance Systems Among SMEs in East Africa**

We carried out a survey to establish the acceptance and application of management and governance systems among SMEs in East Africa. With our consultants’ assistance, we covered 111 SMEs in Kenya (38), Tanzania (25), and Uganda (48), from all economic sectors with special emphasis on agribusiness. The results indicated that SMEs tend to have some systems in place, especially at leadership level, but not much at internal levels. A major challenge in the survey process was the unwillingness of business owner-managers to reveal company information because of privacy concerns and a lack of knowledge of these systems.
Survey Highlights

Kenya

- 87 percent of SME respondents reported improved performances in their businesses after adopting proper management and governance systems; they either attracted investment capital or grew fast.
- 54 percent had shareholders’/partners’ agreements in place.
- Most of them had a functioning board of directors.
- 71 percent prepared annual budgets, which were then voted on by the directors or partners.
- Human resources policies and controls were more widely implemented among them than financial controls were.
- They prepared management accounts, although their frequency varied from each other. Most of them prepared monthly accounts, but some did them less frequently (quarterly and annually).
- Slightly over 50 percent had procurement procedures.
- 66 percent of them had a written code of ethics, which was familiar to their staff who they expected would follow it.
- Generally, they applied many best practices of management and governance in their operations but not in a consistent manner.

Tanzania

- 60 percent of surveyed businesses had a functioning board of directors. The companies with boards conducted regular board meetings and kept records of them.
• 33 percent documented their business plans, which was a matter of concern because most of them were managed by just one or two people with an unclear succession plan.
• At the management level, they were aware of and followed good management principles.
• 60 percent prepare audited accounts, which they shared with their respective boards.
• 13 percent had operations manuals and conducted staff appraisals, which showed a weakness in human resources management.
• 67 percent held regular management meetings.

Uganda

• Regarding management and governance systems, SME respondents registered average ratings on issues of ethics, the equitable treatment of stakeholders and organisational structure. Similar results showed regarding the board’s roles and responsibilities as well as reporting, disclosure, and transparency.
• They considered governance and management systems important to their organisation’s development and performance.
• They thought financial constraints forced them to prioritise specific practices and to neglect others that were equally important to their business success.
• The result of the survey recommended that SME boards should put more emphasis on the board’s roles in the organisational structure, for example, setting of budgets and targets and the development of operational procedures and manuals.
Survey Conclusions

The establishment of strong management and governance systems were hindered due to the following key factors:

- Unawareness of their importance and benefits,
- Financial and time constraints,
- Misconception of the value added by non-executive directors to the business, and
- Negative impact of directors’ fees on the SMEs’ availability of cash.

However, most business owners in the region appreciated the effect of management and governance systems on their businesses' performance. They also showed willingness to learn more about business governance.
Chapter One
Foundations of Business
Management and Governance

The foundations of sound management and governance systems are accountability, proper decision-making process, fairness and equity, and transparency. There is a strong link between these four elements and business performance and endurance.

Accountability

A good management and governance system provides a high degree of accountability to its shareholders and other interested parties. This means managerial and operational problems are easily identified and solved. Accountability is achieved mainly through the establishment of a clear chain of command and distribution of duties.

Proper Decision-making Process

Management and governance systems are viewed as a process of decision making and application. Decisions in an organisation are best achieved with the availability of proper information and wide participation. Proper systems provide an effective method of arriving at decisions through the contributions of all interested parties and a reliable channel of communicating the said decisions.

Fairness and Equity

The organisation’s well-being benefits from how much its members achieve a feeling of inclusiveness. Shareholders and directors, who are not part of daily operations, need to be involved through timely and accurate reports. Employees should feel that their contributions are important to the company’s overall goals, so they could perform better. A system that gives employees clear responsibilities and
acknowledgement for their performance can make them more dedicated and productive in their jobs.

Transparency

Management and governance systems play a major role in promoting transparency. Proper and clear reporting is important to ensure that information is available to all parties concerned. Rules and regulations in the organisation are also understood and followed because of the organisation’s openness.

![Figure 1.1 Foundations of Business Management and Governance](image)

In the following chapters, we discuss best practices of governance systems. Good management and governance systems need to abide by these four basic standards: business control structure, budgeting and cash management, management accounts, and annual audit. They are widely viewed as necessary to establish a reliable organisation. Businesses can customise them according to their needs, without compromising on their essence as best practices. Their respective objectives are:
• **Business Control Structure**: Ensure accountability to all stakeholders and manage relationships with shareholders, the board, management, staff, and other parties.

• **Budgeting and Cash Management**: Instil the discipline of planning, for both profitability and working capital adequacy.

• **Management Accounts**: Keep a close eye on actual income and expenditure against the budget.

• **Annual Audit**: Assure anybody of the reliability of management and financial records and provide an outsider's expert assessment of a company's internal control system.

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**Points for SME Owners and Managers to Think About**

1. Are these foundations in the value system of my business?
2. Does my business management system reflect these foundations?
3. What steps should I take to put the missing foundation/s in place?
The main purpose of a control structure is to allocate responsibilities and functions to various company units and positions. A good structure brings order to an organisation. It provides a guide on how one unit should relate to another, in order to establish efficiency in operations and effectiveness in decision making. It sets out a chain of command for all company employees. SMEs may not need complicated structures such as those adopted by big corporations, but they should establish one that fits their operations and which they can enhance as they grow. An effective organisational structure considers the needs and contributions of the following:

**Shareholders**

Business owners or shareholders are the main interested parties in the control structure because they usually start the business themselves and are the biggest investors. The entire structure is designed to be accountable to them because they have the right of control of the business and its returns and are ultimately responsible for everything within the company. Shareholders set up businesses to serve their interests, so every unit in the structure, including the board and management, have to work towards this objective.
The main function of shareholders in a large-business structure is to appoint a board. In SMEs, however, they are involved in more roles than that. In most cases, they also manage their businesses, which can be an asset because they have a special commitment to the success of the business, as owners. In addition, many of them are actually very skilled in management.

Even under SME conditions, though, the respective roles of shareholders and management have to be defined. Good shareholders should be able to review the management’s performance objectively, even if they may be a part of it. They should be courageous enough to ask themselves if they are the best managers for their business. If they are not, they should give up that role. They should also be professional enough and hold annual general meetings and demand audited accounts to be given in a timely manner, which they should review as a measure of their business success.

**Company Board**

This guide refers to a board as a formal group that is a permanent part of the organisational structure. It meets regularly and has clear responsibilities. Most SMEs associate boards with big corporations mainly because they view themselves as too small for such bureaucracies.

SMEs need to appreciate boards for their roles and contributions to the business. A board’s composition should initially not be a major concern to SMEs as long as it functions effectively. Should the business require external expert advice, the board can expand to accommodate such individuals. Another strength of external experts is that they are less involved in the managing of the business and are not directly affected by decisions, so they have the potential of being more objective. Otherwise, the owners and senior management can serve effectively on the board, with external auditors as advisers on financial and internal control matters.
The board should have regular and scheduled board meetings. These meetings have to be managed professionally, so they can be taken seriously and are productive. Every member should have an opportunity to contribute, with the minutes of the meeting recorded, filed, and ready for review in subsequent meetings. It is recommended that there should be at least two board meetings a year. The board should also contribute to and evaluate the company’s long-term plans as presented by the management. It should also set targets for the management and hold it accountable against them.

Other functions of the board are to:

- Review and approve management accounts, budgets, and audited accounts.
- Appoint senior managers on merit and give them real responsibilities.
- Recommend competent auditors capable of giving appropriate advice and preparing expert, accurate accounts to shareholders.
- Approve other major decisions (for example, loan applications, expansions, etc) accordingly, as they occur.
- Operate in good faith for the company and its shareholders.

Some businesses can benefit much from the expertise of external advisers, but their owners do not use them because of concerns for their company’s privacy. Of course, they forget that even company employees can be considered outsiders. They are also in a position to access and release company information to other ‘outsiders’. SMEs should be encouraged to set up a board in order to deal with the company’s direction, in a more organised and professional manner.

Management

The management is responsible for running a company’s daily operations. Together with the board, it is also in charge of developing a long-term business plan.
As part of its daily duties, the management should ensure that:

- The company complies with all relevant rules and regulations, including appropriate licenses, tax authorities, etc.
- The board is up-to-date with all the necessary information about the company.
- The company manages its risks, both internal and external.
- It uses its knowledge and experience to develop and communicate appropriate recommendations to the board.
- Staff members are treated equitably.
- It employs its expertise for the company’s good.

The main goal of management is to maximise the shareholders’ wealth. The success of this goal normally has a strong correlation with the individual goals of management team members.

Because the management plays an important role in the business, shareholders and the board should ensure that they have the right team for the job. Appointments should be based on merit and positions must be matched with talent. Shareholders and the board should view management as an investment and should make an effort to pay them according to industry standards. Retaining good people should be one of their most important objectives.

Employees should also be given real and clear responsibilities because it is important for their job satisfaction and accountability. In ethnically diverse countries like the ones in East Africa, businesses should make sure that they have a fair mix of staff members from different cultural backgrounds. This sends a message, both internally and externally, that the business is a professionally run organisation.
Other Parties

There are other parties involved in the business control structure, which are not as strongly linked as the shareholders, board, and management but are very important just the same. Their roles in the business do not require the close involvement of the shareholders or the board. At different times, though, any of these entities may influence the business, just like the others do:

- The company secretary is responsible for the efficient administration of a company, especially when it comes to the business’s compliance with statutory and regulatory requirements. An example of these requirements is the filing of annual returns, resolutions, and other legal and required information. SMEs may outsource the function of a company secretary to a third party, while they are still unable to afford one on a full-time basis.
• **Customers** keep the business alive. No matter what a business’s market position is, it should always maintain its focus on satisfying the customer.

• **Creditors** include lenders and suppliers. They are very important to the business’s growth and cash supply. The management should ensure that the company pays its dues in a timely manner and that a good relationship is maintained with them at all times.

• **Regulators** make sure that businesses operate within the law and meet other required standards. Customers like to deal with credible businesses.

• **Communities** play host to businesses, so the latter have a responsibility to them. Communities should be made to feel that a business is part of them and has their interest in mind. Developmental benefits and environmental protection are very important to communities.

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**Points for SME Owners and Managers to Think About**

1. How much of these best practices do I apply in my business?
2. What are my business’s areas for improvement?
3. How much time should I allot for making the necessary changes?
4. Who are the major stakeholders in my business?
Case Study 1
Good African, Uganda

Background

In 2003, Ugandan entrepreneur Andrew Rugasira had an idea: process African products locally for global distribution in order to create sustainable development for farmers and communities. Rugasira founded Good African in 2005, an agribusiness company that processes coffee for the export market; he also became its chief executive officer (CEO). To Rugasira, management is the art of dealing with people, defining goals and objectives, and then rallying people and processes to succeed and achieve desired objectives.

Best Practices and Challenges

At Good African, farmers and customers are treated with utmost respect. They get regular feedback on all business matters through electronic media, meetings, and business exhibitions. Through these interactions, the company can follow up and monitor the effectiveness of its policies, such as sharing 50 percent of its profits with local communities and supporting disadvantaged groups, orphanages, schools, and nurseries. Good African believes smart business is caring for the people you work with. As a CEO, Rugasira sees that it is possible to operate a company profitably within a system of best commercial practices, which places community empowerment at the heart of the business. Good African abides by an ethical code of conduct based on the Biblical principles of love, respect, humility, and generosity.
Rugasira adds that organisations need a policy on reporting, disclosure, and transparency. They have to state clearly, who can give out and/or receive company information. They should also determine the level of details distributed to different stakeholders. Regular staff meetings are held to keep employees posted on business matters. Areas for improvement are periodically identified and the management is encouraged to deal with them. A well-developed organisational structure, with clear roles and responsibilities for the different management levels, is an important tool in holding staff accountable. Good African has a lean, flat structure to speed things up and avoid waste associated with underutilised employees. It also boasts of an actively serving board and a versatile CEO. The company board was appointed by Rugasira, based on individual members’ capabilities and strategic contributions.

Good African has a clear organisational structure (board, executive, and staff), but has challenges when it comes to an autonomous decision-making process. Most decisions depend on the CEO, with minimal accountability to other stakeholders. Rugasira knows this issue and has deliberately encouraged board members and subject-matter experts to evaluate decisions openly.

Another challenge to the organisational structure is that the fulfilment of Good African’s mission requires staff with specialised skills. It is hard to find local people with the skills for producing premium processed coffee. Good African has hired expatriate staff in some key positions, who it hopes will pass their skills onto local staff in due time.

Good African products compete for shelf space with several alternative beverages on the international
market. A distinguishing attribute of its coffee is the 50-percent profit share with growers and their communities. This proposition features prominently on its packaging and requires a high level of integrity and an intricate reporting structure to make it work. Good African is aware of its added responsibility to customers and has set up a foundation to receive and manage the promised profits.

The company has no clear system for tracking unethical behaviour among its stakeholders. It also does not have full control over the market, where several players have different value systems. Good African management has tried to enforce acceptable business conduct by using the principle of zero tolerance. It extends punitive measures against members who breach policies. While this addresses part of the problem, Rugasira sees that the company still needs to improve more by developing and documenting an operational code of conduct.

Case Study Questions for SME Owners and Managers

• What stood out the most for you in this case study?
• What practices could you apply to your business?
• How would you resolve the challenges faced by Good African?
Chapter Three
Financial Management

Efficient financial management is a core element of good management and governance. Without accurate accounts, strong internal controls, and financial planning, it is almost impossible for business owners and managers to carry out their responsibilities effectively and efficiently. Good financial management is made up of budgeting and cash management, management accounts, and audited accounts, which are discussed in the following sections:

Budget and Cash Management

A budget projects a business’s income and expenditure over a defined period. It assists owners and managers to understand how cash moves in and out over time. On the other hand, cash management is an activity that has always been a challenge to businesses around the world. Growing businesses have many cash needs, which must all be prioritised and accounted for.
Profitability does not necessarily mean that the business has available cash. In most cases, at the growth stage, available cash is spent on additional working capital and assets to sustain the development. Business owners and managers then have to manage situations without putting the company through cash strains and, sometimes, failure. Expansion should be run in a way that still allows the business to pay all its immediate obligations, especially to suppliers and creditors. Entrepreneurs are naturally very ambitious and like to take advantage of every available opportunity, but it is wise to have proper budgets that project money inflows and outflows, prior to making new investments.

It is advisable for SMEs to prepare annual budgets. Ideally, each budget should be ready before the intended year starts to ensure that businesses make appropriate preparations early. The budget lays out all the planned expenditure against the expected income. Business plans are then made from a more informed position.

SMEs can also make early preparations to borrow, if they foresee cash shortages. Budgeting is a good way of setting performance targets because it takes into consideration the resources required to achieve those targets.
Management Accounts

Management accounts are necessary to provide updates of the company’s performance. It is advisable for SMEs to produce them after every three months (quarterly). The accounts should include the three main financial statements: profit and loss, balance sheet, and cash flow. They give a clear picture of the business’s financial performance and asset position.

Management accounts also assist in internal decision-making processes. The success levels of targets and budgets are measured through management accounts. After each quarterly accounts report, management can decide on whether to maintain the same trend or to adjust in order to accomplish set targets. The business owners and managers also develop a better understanding of the company financials through management accounts because of their regularity and comprehensiveness. With them, businesses are viewed as more professional by outsiders, especially banks and similar institutions.

Audited Accounts

Auditors carry out a very important role in business management and governance. Their overall duty is to serve the shareholders by investigating company processes and systems. They provide an independent check of information supplied by the board and management to shareholders. They also act as advisers to both board and management on internal processes and tax policies. The auditors’ concentration and expertise is in financial analysis. They are required to abide by acceptable accounting principles and standards.

Due to the sensitivity of the auditor’s role, which involves inspection of management records and systems, their appointment should be carried out as professionally as possible. They should also be given a free hand to carry out their work. Professional standards require auditors to act independently and not to let future business prospects with their clients affect their work.
Points for SME Owners and Managers to Think About

1. Does my business produce management accounts?
2. Are the management accounts comprehensive enough?
3. Is cash flow management a priority in my business?
4. Do the company auditors perform their duties professionally?
Case Study 2
Stantech Motors, Kenya

Background

Stantech Motors was registered as a limited company in 1997, but its trading commenced only in early 1998. The company was formed when four friends – professionals from diverse backgrounds – got together and decided to start the company. The four shareholders also form the company’s board. Initially, they had six employees, but the number currently stands at 212.

The company started by providing motor vehicle body repairs and later expanded to include mechanical and service works. It registered other related companies afterwards, including Four M Autoparts, Four M Insurance Brokers, and Chery Motors. The latter is the newly licensed distributor for Chery, the Chinese brand of new motor vehicles, in East Africa.

Best Practices and Challenges

“We attribute growth to teamwork and focus among the directors and staff. We have an organisational culture that promotes a good working environment, high staff integrity, and low staff turnover,” says Titus Ntuchiu, the executive director of Stantech Motors. “The company’s emphasis on quality workmanship and efficiency ensures that it attracts and retains substantial amounts of business from all reputable insurance companies, private and government corporate bodies, local and international NGOs, and individuals keen on quality work.”
Stantech Motors has a board that meets monthly. As mentioned earlier, the directors are also the founding shareholders. They come from different professional backgrounds and bring diverse expertise and perspectives to decision making. There are two non-executive directors and two executive directors. The chairman is non-executive.

“We view a well-functioning formal board as key to promoting accountability and trust among shareholders. It is also essential for guiding the company to achieve its goals and strategic objectives,” Ntuchiu says. Board members are constantly informed about Stantech’s performance and that of its subsidiary companies. Ntuchiu says that the board sets yearly targets for each company, draws up five-year strategic plans, and follows the implementation of plans through monthly board meetings and biannual retreats.

Stantech Motors has various controls in place to manage its most valuable resource: people. These include a personnel procedures manual, clear responsibilities and reporting lines for all positions, an objective performance measurement process, and recruitment of competent staff through either advertisements or recruitment.

It knows that a good working environment is the key to staff retention, so Stantech Motors treats its employees with respect. The staff contribute to decision making and set their own targets, which are then used in annual performance appraisals. The company also has a range of benefits, including a pension plan, annual bonuses, a company savings and credit cooperative, and fun events/company parties. It also invests heavily in providing comprehensive staff training. This comprises overseas training for the workshop engineers, in mechatronics.
While Stantech does not have a written manual covering finance and procurement activities, some of the key policies that guide its activities include a custom-made integrated computer system, which produces accounts and manages invoices and purchases. The accounts are reviewed by the board against budgets and explanations for abnormal inconsistencies are sought at that time. The company also has strict credit control, security, and HR policies. It uses daily and weekly reports with key performance indicators to monitor performance and compliance. Job rotation is also carried out to minimise possible dishonest scheming.

The Stantech Motors board saw the need to implement such comprehensive HR and financial control systems because the business handles a large volume of sensitive transactions. Ntuchiu explained, “The company must be viewed as trustworthy by its customers; good systems ensure this. With the increasing number of employees, we saw the need to segregate duties.”

Minimal external assistance was required in implementing the controls; most controls were implemented based on staff suggestions, although some met initial resistance and the IT system had teething problems.

**Case Study Questions for SME Owners and Managers**

- What stood out the most for you in this case study?
- What practices could you apply to your business?
- How would you assess the growth of Stantech Motors from 1998 to the present?
Chapter Four
Benefits of Proper Management and Governance Systems

Continuity and Succession

Most businesses, especially SMEs in the East African region, are still owned and run by first-generation owners. There is a general lack of experience in business continuity from one generation to the next. For continuity to be successful, a business should have systems that are not overly dependent on one person. Good governance systems reduce the importance of individuality and emphasise team and system-based operations. Through the chain of command, the governance structure anticipates change of management in every position.

Business owners should also learn the art of easing out of a business, especially as they grow older. They can reduce their role in the day-to-day running of the business and entrust that duty to one of the managers. Letting go of a business by its owners, especially if they started it, is rarely an easy process. However, it is inevitable and the owners have to gain courage to do it in a timely manner.
Appointment of a successor is also a normally challenging task for owners; they find it hard to identify an individual with the same qualities as theirs. They also tend to personalise the selection, which may not be a good approach. One way of making the search process objective and more professional is to involve other individuals or a recruitment agency. Where possible, procedures should be documented to make it easier to transfer them to different individuals.

**Growth and Stability**

A key requirement for organisational growth is an effective structure to support it. The need for qualified employees and specialised departments increases with business development. SME owners should start building appropriate structures and systems early enough to ensure sustainable advances.

Proper management and governance systems establish defined organisational structures, which are favourable for growth. Managers in this type of system are given greater decision-making powers that make operations more efficient. Expansions also become realistic because the structures allow departments and branches to be held accountable effectively.

One of the key challenges of growth is tracking the increased operations with accuracy. As the business expands, the business owner’s ability to supervise it personally and effectively is reduced. However, through management and governance systems, controls are simplified, which make it easier for owners to track business activities with little involvement.
Easier Problem Detection and Risk Management

Risk management is a continual process in any organisation. Reducing risk and improving response time to problems are some of the main qualities of a good management and governance system. Different accountability levels improve discipline in the entire command chain because they act as checks and balances for each other.

Holding SME owners accountable can be challenging. It is very common for them to view and treat the business assets as their personal belongings. All business assets are important for the company’s continuity and growth, so any movement should be managed professionally and not at the owners’ wishes. Cash movement can be especially very sensitive. Business owners should ensure that any funds borrowed or lent to the business should be recorded and treated appropriately. In addition, funds that are drawn out of the company in the form of salaries or dividends should be done in a structured manner, so they do not hurt the business. The
process is made easier by a proper financial reporting system and employment contracts. Records of every asset movement need to be captured, so it is clear how they are utilised and what they result to.

Greater Customer and Investor Confidence

Investors, customers, and creditors generally like dealing with businesses that have some openness and structure to them. Investors can be very particular with governance systems because they prefer to invest in the form of equity and become shareholders in the business. They normally insist on a defined governance system that provides them a chance to contribute and influence decision making. This also allows them access to necessary information.

For fast-growing SMEs in East Africa, it is becoming popular to raise funds through equity. They are increasingly inviting new partners and investment funds to take up shares in their companies. It is then advisable to set up proper management and governance systems in anticipation of future fund-raising.

Points for SME Owners and Managers to Think About

1. Has my business experienced the benefits mentioned above?
2. What is the reputation of my business, both internally and externally?
3. Can I identify risks in my business, with ease?
4. Can my business continue in my absence?
Case Study 3
Eldoville Farm, Kenya

Background

Eldoville Farm is a family-owned business located in the Karen suburb of Nairobi, which is about 15 kilometres from the Central Business District. It manufactures value-added food products in the dairy, vegetable, and fruit categories. It grows just small quantities of vegetables, preferring to source most of its produce from third parties. It also has a few cows, whose milk is processed alongside that sourced from a farmers’ cooperative. The cows also provide manure for growing the vegetables and for producing biogas. Staff meals are cooked using the biogas. Eldoville’s strength lies in its quality assurance procedures. Lucy Karuga, who founded and manages the farm, says, “Our strength lies in quality. Without quality, we would be nowhere.”

Best Practices and Challenges

Eldoville has invested in meeting the Hazard Analysis Critical Control Point (HACCP), a hygiene certification issued by SGS, an international auditing and certifying agency. Eldoville was first issued the certification in February 2008, which is valid for a three-year period ending in 2011. However, SGS carries out audits every six months to ensure that the standards, which led to the original certification, are being upheld.

Eldoville customers also pay regular visits to ensure that it adheres to the set standards and to train the staff to meet their specifications. NAS, an airline food service provider, visits the farm three times a
year; Nairobi Hospital, twice a year; and hotels, in similar intervals. Hotels can be especially challenging because chefs require their vegetables cut in a particular size and shape. They like to outsource the cleaning and preparation of vegetables and fruits to Eldoville because it knows what it buys. The chef does not have to worry about the quality and cleanliness of the food they serve – be it fresh salad or mashed potatoes. Eldoville now plans to secure a higher certification level come February 2011: ISO 22000 certification, which is for safe food-supply chains.

A certification opens doors for a business. Eldoville’s quality assurance procedures also allow it access to first-rate customers. Another business benefit is that customers choose to enter into multiyear contracts with it. It enables the business to plan for investments in production equipment or refrigerated trucks.

Eldoville is able to track the age of all stock and thus avoid wastage from overstocking. It emphasises milk deliveries daily, as required for the fresh produce. All finished stocks are also labelled with the date of manufacture.

Eldoville is multi-awarded at both employee and company levels. In 2009, its cheese team leader won a scholarship for a three-week training in cheese making in France. Further testimony of its products’ quality is from some of its other awards:

- Four first prizes for four of its cheeses (Camembert, mozzarella, mild cheddar, and Brie) in the East and Southern Africa Dairy Association competition in 2006, and
• First prize nationally in National Conservation, in 1999 (Presidential Commission on Soil Conservation and Farm Management).

Eldoville has become a demonstration farm as it receives many school and government delegations annually. The Kenyan government encourages more farmers to move up the value chain, so they too can boost their incomes. The farm does not sell milk or fresh produce. Any product they sell should have value added to it. For this reason, income is higher than if the farm focused on selling fresh milk and produce.

Case Study Questions for SME Owners and Managers

• What stood out the most for you in this case study?
• What practices could you apply to your business?
• How do you propose to strengthen Eldoville Farm’s position in getting the new certification?
Conclusion

The business environment in East Africa is changing fast, so SMEs in particular need to embrace systems that allow them to prosper and survive the test of time. Business owners cannot continue operating with a ‘small-shop’ mentality and hope to grow. It is a gradual and challenging process to build businesses and develop systems that allow them to run with little supervision by the owner, but it needs to happen. Management and governance systems do not have to be expensive, just functional. SMEs should approach them positively and with a sense of their inevitability.
Annex 1: How to Apply Best Practices to Your Business

Whether you do it yourself or with a business adviser, consultant, or company auditor, the following steps can help you apply best practices in your business:

1. Determine the objective of the systems and controls.
2. Identify the opportunities and risks, which the systems need to address.
3. Establish the magnitude and likelihood of the risk occurring. If the risk is low and likelihood is very low, then it may not be important to implement the control.
4. Agree on the most efficient way of addressing the risks. This will require the SME manager to carry out a comparison of the costs and benefits of implementing the controls, remembering the information obtained in step 3.
5. Implement the chosen systems. Before you do this, share the benefits of the new system with the affected personnel in your business to minimise resistance to its implementation. In particular, SME owners need to win the support of their key managers. It will also be important to create a sense of urgency among their staff to help them adopt the new system quickly.
6. Review the system periodically for its effect. If it does not produce the desired effect, then try to improve it. Seek feedback from the staff involved in implementing the system. Find out how things could be done better.

Lead by example. In a sense, implementing systems is changing the way SMEs do things. This means changing the organisational culture. Actions truly speak louder than words, so business owners and managers must go in front of the team and forge ahead.
Annex 2: Sample Agenda Formats

Agenda Formats

Annual general meeting and board meeting agendas have no set format, but the following examples can be customised to the needs of SMEs.

Annual General Meeting Minutes

(Date)
(Venue)
(Expected start and end time)

<table>
<thead>
<tr>
<th>Item</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Members</td>
<td>Roll call</td>
</tr>
<tr>
<td>Proxies</td>
<td>Presentation and acceptance of proxies</td>
</tr>
<tr>
<td>Directors’ Report and Audited Financial Statements</td>
<td>Presentation of report on the company status</td>
</tr>
<tr>
<td></td>
<td>Presentation and adoption of audited accounts</td>
</tr>
<tr>
<td>Directors</td>
<td>Appointment of directors</td>
</tr>
<tr>
<td>Share Capital</td>
<td>Presentation of any change in the share capital</td>
</tr>
<tr>
<td>Auditors</td>
<td>Arrangement for auditors’ remuneration</td>
</tr>
<tr>
<td></td>
<td>Appointment of auditors</td>
</tr>
<tr>
<td>Closure</td>
<td></td>
</tr>
</tbody>
</table>
Board Meeting Agenda

(Date)

(Venue)

(Expected start and end time)

<table>
<thead>
<tr>
<th>Item</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Call to Order</td>
<td>Chairperson opens the meeting.</td>
</tr>
<tr>
<td>Attendance and Apologies</td>
<td>Roll call of directors begins.</td>
</tr>
<tr>
<td>Board Appointments and Resignations</td>
<td>Chairperson reports any changes in directors.</td>
</tr>
<tr>
<td>Agenda</td>
<td>Board amends and approves the agenda.</td>
</tr>
<tr>
<td>Minutes of Previous Meeting</td>
<td>Directors agree or not to the minutes read.</td>
</tr>
<tr>
<td>Discussion of Matters Arising from Minutes</td>
<td>They review previous minutes and take action.</td>
</tr>
<tr>
<td>Chief Executive Report</td>
<td>CEO reports on major events, actions, and plans.</td>
</tr>
<tr>
<td>Business Strategy</td>
<td>Board does an annual review.</td>
</tr>
<tr>
<td>Marketing Report</td>
<td>It does an annual review for this, too.</td>
</tr>
<tr>
<td>Approval of Annual Financial Statements</td>
<td>Board approves statements.</td>
</tr>
<tr>
<td>Audit Report</td>
<td>It considers auditors’ report and feedback.</td>
</tr>
<tr>
<td>Remuneration Review</td>
<td>It reviews senior management pays and bonuses.</td>
</tr>
<tr>
<td>Agenda and Date of Next Meeting</td>
<td>Board sets date and content of next meeting.</td>
</tr>
<tr>
<td>Any Other Business</td>
<td></td>
</tr>
<tr>
<td>Closure</td>
<td></td>
</tr>
</tbody>
</table>
Annex 3: Roles of Board Chairperson and Directors

Chairperson

- Harness collective skills of the board and management.
- Exercise leadership and good interpersonal skills.
- Maintain a close but independent relationship with the CEO.
- Allot sufficient time to deal with board and company matters effectively.
- Conduct board meetings efficiently.
- Be the ultimate decision maker.
- Facilitate ideas and provide options.

Director

- Act in utmost good faith and in the best interest of the company.
- Be available to deal with board and company matters effectively.
- Study all information necessary to make informed decisions.
- Be independent from outside influence.
- Ensure adequate checks and balances are in place in the organisation.
- Use adequate oversight to ensure conformity.
- Increase shareholder value.

Conflict of Interest

Directors should avoid any conflicts of interest between the company and themselves. Any situation that involves or may involve a conflict of interest with the company should be disclosed promptly to the board chairperson. Where this occurs, directors should immediately withdraw from the discussions relating to the actual or potential conflict of interest.
Annex 4: Online Resources

Centre for Corporate Governance
www.ccg.or.ke

Institute of Corporate Governance of Uganda
www.icgu.or.ug

Institute of Directors Kenya
www.iodkenya.co.ke

Kenya Private Sector Alliance
www.kepsa.or.ke

Private Sector Foundation Uganda
www.psfuganda.org

SME Toolkit Kenya
kenya.smetoolkit.org/kenya/en

Tanzania Private Sector Foundation
www.tpsftz.org
Annex 5: Organisational Profiles

African Agricultural Capital
(www.aac.co.ke)

AAC is an investment management firm that specialises in venture capital investment in agriculture-related SMEs in East Africa. At the time of its launch in 2005, it had a capital of USD 7 million from The Gatsby Charitable Foundation, The Rockefeller Foundation, and Volksvermogen. Since then, Gatsby has invested a further USD 2 million into AAC. These contributions were channelled through the Kilimo Trust.

AAC has successfully established itself as an investment company. Foreign direct investment goes through it to help reduce food shortages and broaden economic growth by developing a more successful, competitive, and innovative agricultural sector. AAC has already made 16 investments of around USD 7.3 million into various agricultural companies.

SNV Netherlands Development Organisation
(www.snvworld.org)

SNV is a nonprofit international development organisation established in the Netherlands in 1965. SNV has been present for over 40 years and now operates in 35 countries in Africa, Asia, Latin America, and the Balkans. SNV’s advisors come from a variety of cultural and technical backgrounds. Over 60 percent are nationals of the countries where SNV is active. SNV’s head office is in The Hague, The Netherlands. It also has an office in Washington DC, USA.

SNV supports national and local participants within government, civil society, and the private sector, to develop and implement local solutions to social and economic development challenges. The organisation seeks to stimulate and set the framework for the poor to strengthen their capacities and escape poverty. This is achieved by facilitating
knowledge development, brokering, networking, and advocacy at the national and international levels.
Authors’ Profiles

**Wanjohi Ndagu** is the investment manager for African Agricultural Capital (AAC), a venture capital investment fund created to invest in agriculture-related SMEs in East Africa. He is a Bachelor of Commerce graduate from Daystar University in Kenya and an MBA graduate from the University of Phoenix. He joined AAC with experience from JPMorgan Chase, where he worked as an operations associate and an investor relations specialist. Ndagu serves on the board of five investment-recipient companies in the East African region.

**Richard Obuobi** holds a Master of Science degree in Actuarial Science and a Bachelor of Science degree in Civil Engineering. He has several years of investment banking experience and has worked on various multimillion-dollar projects in energy, health care, oil and gas, and mining. In April 2009, he joined the Netherlands Development Organisation (SNV East and Southern Africa) as a senior regional investment advisor. Obuobi is a Level II candidate for Chartered Financial Analyst, Financial Risk Manager, and is pursuing a fellowship in Actuary at the Institute of Actuaries in Great Britain.
Most SME owners across the world consider business management and governance (corporate governance) as something relevant only to large corporations. In many African countries, the concept is still new and unfamiliar even to some big companies. In this book, we encourage SMEs to embrace it as an essential part of their development as businesses.

This guide recommends the carrying out of management systems and processes to ensure successful and stable businesses. It provides tips and tools to SME owners, so they could avoid the 'one-man show' approach that is very common among them. The guide also deals with best practices and benefits of management and governance systems, including business case studies of SMEs that have successfully applied proper management systems and processes.

The need for good governance is no longer the preserve of listed companies because proper management and governance are very important components of success for all businesses. Today's SMEs are the economic leaders of tomorrow, provided they embrace best business practices, so that real transformation can be realised in our economies. This guide presents the fundamental practices that an SME needs to employ in order to attain sustainable growth. It is my hope that the Ugandan business community will develop a deeper appreciation of good business governance practices to deliver the desired change.

Sam F Owori
CEO, Institute of Corporate Governance of Uganda

The Kenyan SME sector is going through a transformation; businesses are venturing into new markets at a fast rate. Management infrastructure and governance systems, therefore, have to keep up with the pace and support these changes. Business systems, like many other facets of life in Kenya, are always catching up, so this guide is both relevant and timely.

Carole Kariuki
CEO, Kenya Private Sector Alliance

As a believer and promoter of best business practices, I think this guide is a great tool for SMEs. Businesses need to plan for the future; having the right supporting structures is critical to that.

Dr Evans Rweikiza
Executive Director, Tanzania Private Sector Foundation

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