AGENDA FOR IMPROVING THE CORPORATE GOVERNANCE OF UNLISTED COMPANIES

Corporate Governance

FINLAND CHAMBER OF COMMERCE
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This is an updated version of the Agenda for improving the Corporate Governance of Unlisted Companies issued by Finland Chamber of Commerce in January 2006. In the updated version, we have taken into account the needs of SMEs better than before and highlighted new topical issues, such as corporate responsibility and information security as part of risk management.

The Board of Directors of Finland Chamber of Commerce established on 18 October 2004 a working group for the purpose of studying corporate governance practices in unlisted companies. On the basis of the proposals by the working group, the Board of Directors of Finland Chamber of Commerce issued an Agenda for Improving the Corporate Governance of Unlisted Companies, i.e. companies that were not felt to be able to implement the Corporate Governance Code for Listed Companies, but that nevertheless desired to improve their operations actively and in conformity with good corporate governance.

Implementation of the agenda is voluntary. On the basis of the agenda, companies may evaluate their own practices and determine, whether they need to amend or improve their corporate governance. The agenda does not oblige companies to apply any certain procedures, nor to implement certain structures. Neither do companies need to publicly give any reasons for their choices concerning corporate governance. No time limit is set for implementing the agenda; companies may use it according to their own needs.

The aim is to, above all, make corporate governance more flexible, instead of increasing bureaucracy, and to complement any other codes of conduct that the company may apply internally. The idea is to help a company concentrate on its core operations through efficient corporate governance. Efficient corporate governance also improves the information flow, which makes it easier to take care of matters and increases the confidence of interest groups. Good corporate governance also improves the credibility of the company and its access to financing. It may increase interest in owning company shares and joining the board of directors.

The agenda is divided into chapters concerning general meetings, the board of directors, managing director, remuneration schemes, internal control and risk management, audit, articles of association, shareholders' agreements, redemption and approval clauses, and communications and information. Furthermore, the agenda contains a chapter on social responsibility and a chapter for family-owned companies on generation changes and family councils.
Each chapter begins with a general description, then there is a list of questions that may serve companies when evaluating whether sufficient attention has been paid to the matters concerned and whether the company needs to improve its systems. After the questions, the matter is motivated in greater detail.

The primary purpose of the agenda is to serve limited liability companies, but the principles may be applied to other company forms as well.

It may be more appropriate for larger unlisted companies to apply the Corporate Governance Code for listed companies issued by the Securities Market Association as far as it is possible with regard to their special features, based on the ‘comply or explain’ principle (www.cgfinland.fi). Smaller companies may find the Code too heavy to apply.

*Finland Chamber of Commerce issued a statement in January 2006 urging the largest unlisted companies to follow the recommendation for listed companies as far as possible considering the special features of these companies, in accordance with the ‘comply or explain’ principle. The statement is still applicable.*
As background from the Limited Liability Companies Act

The central provisions with regard to corporate governance are found in the Finnish Limited Liability Companies Act (624/2006), which establishes the framework for the company organisation and operations. The Act defines, among others, the organs of the company, their tasks and responsibilities and internal relations.

The Limited Liability Companies Act valid in Finland is flexible. It is by nature voluntary, which means that it establishes the framework for operating as a limited liability company but gives the company the opportunity to arrange its operations, financing, distribution of means and other matters fairly freely. On the other hand, there are provisions of the legal rights of minority holders and creditors.

The first chapter of the Act contains general principles that may not be departed from. These general principles build the basis for the interpretation of more detailed provisions. The majority of the provisions in the Limited Liability Companies Act are voluntary: the shareholders may stipulate on the company operations in the articles of association and, in addition, unanimous shareholders may in individual cases depart from both the Act and the articles of association.

The Limited Liability Companies Act (above all Chapters 5 to 8) contains provisions on corporate governance. Even in this respect, the Act is flexible. Legislation is supported by different recommendations, which are used for unifying manners of operating and promoting the transparency of governance and remuneration.

With the help of this agenda, companies may assess their own procedures and decide if they need to alter or develop their corporate governance.
Governance model and organs

Finnish limited liability companies have, as a rule, a one-level governance model consisting of the following organs: general meeting of shareholders, board of directors and managing director. However, a company may, in accordance with the Limited Liability Companies Act, have a supervisory board (two-level governance model). Very few companies have a supervisory board, as the structure is almost without an exception unnecessarily heavy for Finnish SMEs.

The administrative decision-making bodies of a limited liability company are the general meeting, board of directors and managing director, if the company has elected a managing director.

A limited liability company usually also has an auditor elected by the general meeting. The auditor has an important position as an audit organ appointed by the shareholders. The audit comprises the accounting, financial statements, report by the board of directors, and administration of a financial period. The audit provides the shareholders with an independent statement on the company's financial statements and report by the board of directors as well as the accounting and administration. In certain situations, the company is obliged to elect a so-called KHT auditor or a KHT audit firm.¹

¹ In a listed company, at least one of the auditors must be approved by Finland Chamber of Commerce (“KHT auditor” or “KHT audit firm”). This also applies to companies that met at least two of the following criteria during the latest financial period: 1) the balance sheet total exceeds 25 000 000 euros; 2) the net sales or corresponding income exceeds 50 000 000 euros; or 3) the company has more than 300 employees on an average
General principles of the Limited Liability Companies Act

The principles that are central for the operations of a limited liability company can be found in the Limited Liability Companies Act.

Legal personality and the limited liability of shareholders

A limited liability company is a legal person distinct from its shareholders. It has legal capacity and it may have rights and obligations. The assets of a limited liability company are separate from those of its owners. Shareholders are not personally responsible for the company’s obligations. The only risk that a shareholder bears is possible loss of the capital he or she has invested in the company. The articles of association may, however, stipulate on a shareholder’s obligation to pay certain fees to the company.

Permanence of capital

A company has a share capital. The minimum share capital of a private limited liability company is 2,500 euros and that of a public company 80,000 euros. The assets of a company may be distributed only as provided in the Limited Liability Companies Act.

Transferability of shares

A share may be transferred and acquired without restrictions, unless otherwise provided in the articles of association (see also Redemption and Approval Clauses).

Purpose

The purpose of a company is to generate profits for the shareholders, unless otherwise provided in the articles of association.

In practice, generating profits is looked at on a longer term, and the principle does not usually mean short-term profits. The articles of association may also state that the company has some other purpose.

Principle of majority rule

According to the principle of majority rule, the shareholders shall exercise their power of decision at the general meeting. Decisions shall be made by the majority of the votes cast, unless otherwise provided in the Limited Liability Companies Act or in the articles of association. Certain decisions, such as amending the articles of association, require a decision by a qualified majority (2/3 of given votes and shares represented at the meeting) or a unanimous decision.
Equal treatment

Several provisions of the Limited Liability Companies Act refer to the principle of equal treatment. It is intended for protecting minority shareholders. According to the principle, all shares shall carry the same rights in the company, unless it is otherwise provided in the articles of association. The general meeting, the board of directors, the managing director or the supervisory board shall not make decisions or take other measures that are conducive to conferring an undue benefit to a shareholder or another person at the expense of the company or another shareholder.

Duty of the management (loyalty and due care)

According to the principle, the management of the company shall act with due care and promote the interests of the company. The management means the board of directors, the supervisory board and the managing director.

Meeting the duty of care has significance, when assessing the management’s liability for damages. An actor shall prove that he or she has acted like a careful person would act in corresponding circumstances. Taking a business risk may be acceptable, if it can be shown that the person in question has acquired sufficient background information, on the basis of which he or she has made a rational decision, and the management’s own interests have not had an impact on the decision, i.e. the decision has been made in the best interest of the company and all its shareholders.

The duty of loyalty means acting in the best interest of the company, and ultimately, in the best interest of all shareholders. The principle also indicates that acting in the best interest of only a certain shareholder or a group of shareholders is not permitted.

Discretion of shareholders

According to this principle, the shareholders may include provisions on company operations in the articles of association. Provisions contrary to a mandatory provision of the Limited Liability Companies Act or some other Act, or contrary to the rules of appropriate conduct, shall not be included in the articles of association, however. The flexibility of the Limited Liability Companies Act also means that shareholders who are unanimous may depart from provisions of the articles of association or some other provision that is not mandatory by law.
On the meaning of the articles of association

The Limited Liability Companies Act contains several presumptions, which a company shall apply unless otherwise provided in the articles of association. The articles of association contain detailed provisions on the ways in which the company organs operate.

The articles of association apply to all shareholders, the company management, other company representatives and the auditors. The articles of association shall fulfil the minimum requirements of the Limited Liability Companies Act, i.e. contain at least: 1) the trade name; 2) the municipality in Finland where the company has its registered office, and 3) the field of operation.

The articles of association may be rather narrow in scope, but from the shareholders' point of view it may be appropriate to also include in the articles of association provisions on, e.g.:

- the share capital
- the nominal value and number of shares
- the number of directors and auditors as well as the number or minimum or maximum number of deputy directors, if any
- representation rights
- the notice of a general meeting
- matters on the agenda of the annual general meeting
- the company’s accounting period
- further regulation
- other provisions.

From the investors' point of view and for the representation of the company, it is important to define the company's field of operation in sufficient detail. For the purpose of controlling ownership relations, the articles of association may contain so-called redemption and approval clauses.

Flexible articles of association enable the company to grow without having to amend the articles of association. An amendment of the articles of association requires a qualified majority of at least 2/3 of the votes given and the shares represented at a general meeting. The articles of association may not include a provision that is contrary to a mandatory provision of the Limited Liability Companies Act or some other Act, or that are contrary to the rules of appropriate conduct.

2 The Finnish Patent and Registration Office presents on its website a package for establishing a limited liability company, which contains two templates for articles of association. The first template contains the items that are mandatory according to the Limited Liability Companies Act, i.e. trade name, field of operation and domicile. In addition, it contains a provision on the right of the board to issue a certain person procuration or the right to represent the company. The second template includes, in addition to the trade name, domicile and field of operation, central provisions of the Limited Liability Companies Act that are traditionally included in the articles of association. It also has a clause on representation rights, which makes it easier to represent the company, and a redemption clause.
The shareholders of limited liability companies use their decision-making powers at the general meeting. The meeting elects the company’s board of directors. Shareholders’ right to speak and vote at a general meeting also includes the right to ask questions, as well as the right to submit draft resolutions concerning matters on the meeting’s agenda.

Do the company’s owners get sufficient information about the company, its organs and auditors? Is the general meeting organised in such a manner that participation is easy for the shareholders? Do the directors, the director candidates and the managing director attend the meeting? Should the auditors attend general meetings?

The documents of the meeting, such as the draft resolutions and financial statements, shall be available at the company’s head office or on its website as well as at the meeting. The documents of the meeting shall be sent to a shareholder requesting them without delay, if the documents cannot be downloaded and printed from the company website.

Advance information enables the shareholders to assess their need to attend the meeting, to decide how to vote and the need to make questions at the meeting. Shareholders not attending the meeting also get information about the company and can thus make decisions concerning their holdings. The company provides advance information in a notice of a general meeting, in other notices and possibly on the Internet, depending on the company size.

Arrangements for the general meeting, such as time, place and advance information, are means for giving shareholders better opportunities to attend. Attendance of the directors and the managing director promotes interaction between shareholders and the corporate organs. The Limited Liability Companies Act also requires sufficient attendance so that the shareholders’ right to ask questions can be fulfilled. In this way, shareholders can get more detailed information about matters that may have an impact on the evaluation of the company’s financial statements, its financial position, or of other matters on the agenda of the general meeting.

It is recommended that a person who is directors candidate for the first time is presented to the shareholders at the meeting that decides on the election.
The board of directors is responsible for the administration of the company and for the appropriate management of its business. The board guides and supervises the company’s operations and its managing director, it appoints and dismisses the managing director, it approves the company’s goals and objectives and its risk management principles. The board ensures the appropriate function of the company’s management system and is furthermore responsible for the supervision of the company’s accounts and the administration of its finances. The duty of the directors is to promote the company’s and all its shareholders’ interests, irrespective of who has proposed their candidacy for board membership.

Is the number of directors suitable for ensuring effective management and good administration of the company?

The number of directors is determined from case to case, according to the company’s needs and starting points. Factors that have an impact on that number are, e.g. the scope of the company’s business and the distribution of its shares. In companies with a wide ownership base or extensive business operations, the effective execution of the board’s duties may typically require a larger number of directors. On the other hand, if the same person both owns and manages the company, only one director and one deputy director is sufficient in most cases.

Do the directors have enough time for carrying out their duties on the board, in addition to their other engagements? Is the composition of the board sufficiently diversified? What are the strengths and weaknesses of the board? What further expertise and experience could be obtained to make the board more effective in future? Could the board’s conduct of business be improved by electing one or several directors who do not have any prior close relations with the company? Is the rotation of directors sufficient?

Successful fulfilment of the board’s duties requires knowledge of business operations or of their different aspects. In order to guarantee good work by the board of directors and an efficient execution of its duties, it is important that the board is composed of persons with diversified and complementary experience and expertise. In addition to expertise, it is important that the directors have a critical mind, that they form their opinions in an independent manner and that they are co-operative. The directors’ age and the representation of both genders are also factors to consider when deciding on the composition of the board.

It is the duty of the board of directors to guide and to supervise the company. By appointing persons who do not previously have any close relations with the company, it is possible to improve the board’s conduct of business for the benefit of the company and all its share-
holders. Diversity promotes good corporate governance and efficient supervision of the management as well as succession planning.

When electing directors, it should be made sure that the candidates have the possibility to attend to company business to a sufficient extent. The directors, and particularly the chairman, are also required to work between meetings. Questions such as the directors’ main and secondary occupations and simultaneous board memberships, are factors that help to evaluate whether the directors have sufficient time for carrying out their duties.

There should be sufficiently of both old experience and new ideas on the board. Through rotation, it is possible to make sure that the board renews itself and that its expertise is updated.

**Is the board’s work evaluated by the board itself, or by an external evaluator?**

The efficiency of the board’s work may be improved by regularly monitoring its conduct of business and working methods. The evaluation can be made either as self-evaluation or by using an external evaluator. An evaluation should always be made before electing directors, and it may cover, e.g. the internal work distribution of the board and its efficiency, the contribution of each director in the work and his or her expertise in relation to the company strategy, the satisfaction of the directors and the need for rotation, the operations of the chairman, preparations for meetings as well as other development needs.

**Do all directors get information about the company sufficiently and equally? Are the directors sufficiently well acquainted with the company’s business?**

For the execution of their duties, the directors need information about the company’s structure, business and markets. Initiation of new directors in the company’s business operations and the distribution of the necessary information to all directors promote the efficient operations of the board. Sufficient and equal information is important to enable the board to operate well, in particular for those directors who are not officials of the company or its shareholders.

**Does the chairman of the board lead it efficiently? Does the co-operation between the chairman and the managing director function well?**

The chairman is responsible for leading the board of directors and also for communicating the shareholders’ views and opinions to all directors. The activity of the chairman of the board greatly influences the entire board’s effective fulfilment of its duties and ensures that the board makes use of its expertise for the benefit of the company. The chairman makes sure that matters are handled with care and expediently. The chairman’s activity is also important for providing the directors with supplementary information about the company on a continuous basis and for the board’s evaluation of its own operations. The co-operation between the chairman and the
managing director is essential for the management of the company business. If the actors trust each other, it is possible to challenge the managing director in a constructive manner.

**Does the company’s board of directors have a charter? Have the charter and the areas of responsibility of the directors been drawn up in writing? Has an annual clock been set out for board work?**

Effective conduct of the board’s business can be promoted by defining its essential duties and operating principles in a written charter. The charter may, e.g. contain provisions on the work distribution between the directors, the frequency of board meetings, the extent to which deputy directors are involved in the board’s work and how the directors are invited to meetings. The planning of the board’s work and anticipation of the preparation of matters may also be facilitated by the use of an annual clock, which contains the most important matters included in the board’s work by month.

**Has the board decided on efficient meeting practices? Do the directors get information on an equal basis? Does the minutes practice of the board function well?**

The work of the board of directors may be improved by ensuring that the directors receive the documents of the meeting in good time in advance. In this manner it can be made sure that all directors can prepare themselves for the meeting after having obtained information on the company and the matters to be decided on in a sufficient and equal manner. The company shall also see to it that the meetings are well prepared, that the agenda is appropriately scheduled and that there is an open and communicative atmosphere at the meeting.

Minutes shall be drawn up at board meetings. The minutes shall be signed by the chairman of the meeting, and if there are several directors, at least one director elected by the board for this purpose. Minutes shall be numbered in running order and stored reliably. It must be possible to afterward ascertain the decisions made and the motivations to them from the minutes and their appendices. Well prepared minutes including appendices will help the board show that it has acted according to the principle of due care.

**Are the directors aware of the legal liabilities involved in their work? Do the directors need a liability insurance?**

The responsibility of the directors is based on their obligation to promote the company’s interests in a prudent and conscientious manner. The directors are also responsible for complying with the Limited Liability Companies Act, with other legislation and with the company’s articles of association. Directors may have to answer for their decisions to the company, to its shareholders or to third parties. As a main rule, all directors are jointly and severally liable. The chairman of the board carries stricter liability for control and supervision, for preparing matters and for the decision-making procedure. The directors are
liable under both civil and criminal law. The consequence of negligence may be liability for damages or criminal sanctions.

It is possible to sign a liability insurance policy for the management (managing director and board) with regard to the liability for damages according to the Limited Liability Companies Act. In general, the policy is better suited for companies where the company management mainly consists of others than owners of the company. The terms of insurance policies often set owners with a certain percentage of holding outside the scope of the policy.

**Does the management of the company need an external advisory board? Have its operating principles and relation to the decision-making bodies been defined clearly?**

It is possible to establish an advisory board to support the company owners and management. Like the board, the advisory board convenes regularly and according to plan in order to develop the company and its operations.

With an advisory board, the company may prepare itself for official board work. The advisory board may also support or develop the work of the existing board. It may challenge the company in a new situation or act as advisor for the company management and bring versatile experience and expertise to the company as support for decision-making.

An advisory board is not an official decision-making body of the company. The company management, i.e. the board or managing director, cannot transfer their responsibility to the advisory board.
Managing Director

The company may have a managing director. The board of directors appoints and may dismiss the managing director. The managing director administers the company’s day-to-day business according to orders and instructions issued by the board of directors. Taking into account the extent and nature of the company’s business, the managing director may take measures having exceptionally unusual and extensive implications only upon authorisation by the board of directors. The managing director shall ensure the conformity with the law of the company’s accounts and of the reliable organisation of its financial administration. The managing director shall give the board of directors and its members all information needed to carry out the board’s duties. The managing director is independently responsible for discharging his or her duties.

Depending on the extent of the company’s business, it may also have a management team, which assists the managing director in preparing and making decisions. The management team has no official standing under company law; its powers and liability are the same as those of the managing director. The managing director’s opinion constitutes the decision of the management team. Small companies do not usually have a management team.

Have the essential terms of the managing director’s service been defined in writing? Is the division of tasks between the managing director and the board of directors clear? Is the chairman of the board a person other than the managing director? What measures have been taken to ensure the flow of information between the managing director and the board of directors? How have questions concerning the managing director’s successor and deputy been settled?

The managing director is a company organ under the Limited Liability Companies Act. The managing director has no contractual employment relationship with the company. Neither is he or she an employee of the company, because the managing director does not work under the supervision of the employer. The Employment Contracts Act does not apply to the managing director and he or she enjoys no protection against unjustified dismissal by virtue of said Act. A written service contract containing the terms of service clarifies the relation between the company and its managing director. Such a contract safeguards both the company’s and the managing director’s interests, and possible conflicts between the company and its managing director can be avoided.

The managing director’s obligations, responsibility and rights should be defined clearly. It may also be necessary to determine when the managing director shall submit his or her decisions for approval to the board of directors and what the distribution of tasks between
the board and the managing director is. In an ideal situation there is a continuous and interactive dialogue between the board of directors and the managing director and they manage the company’s business together. The board supervises and supports the managing director.

The Limited Liability Companies Act permits the election of the managing director as chairman of the board of directors. However, a differentiation of duties seems natural, because one of board’s duties is to supervise the managing director. Decision-making powers are not excessively concentrated to only one person, if the scope of the managing director’s and the board chairman’s responsibilities is clearly differentiated. The managing director shall give the board of directors all information that the latter needs for fulfilling its tasks. If needed, the board of directors determines what information it must have.

The company should have plans for a successor and for somebody to temporarily take over the managing director’s tasks and responsibilities in case there is a change of the managing director. The succession planning of the managing director is part of board work. In the election and succession planning of the managing director, it is absolutely necessary to foresee and assess the strategy, goals and organisational requirements that will be placed on the managing director. Succession planning is easier if the board meets the key personnel of the company on a regular basis and obtains information about it. It contributes to succession planning and the assessment of the managing director’s work that the board discusses the matter on a regular basis without the presence of the managing director.

How is the operative management organised? Are the respective areas of responsibility clearly defined?

A management team has no official position under company law, but at a practical level it may play an important role in the company’s organisation. A written definition of the management team’s composition, tasks and the members’ respective areas of responsibility may clarify the company structure.
Persons working for the company may be remunerated and bound to the company by means of different remuneration schemes. The purpose of such a scheme is to influence the activities of the persons concerned so that the company achieves its goals. The aim of remuneration is to promote the company’s long-term financial success, competitiveness and the favourable development of shareholder value.

Does the remuneration scheme encourage to long-term financial success and the growth of shareholder value? Have the principles and decision-making concerning remuneration been defined clearly? Does the remuneration scheme contain other than financial measures, such as customer satisfaction, security of deliveries, satisfaction at work, corporate responsibility, or health and safety at work?

A company may decide whether it will establish remuneration schemes, what kind of schemes it will use and the persons whom the schemes cover. In addition to the basic salary, such schemes may include, i.e. incentive schemes related to the company’s financial results, pension schemes and share-based remuneration schemes.

Remuneration must be in right proportion to the company’s development and long-term value building. Binding remuneration to performance and result criteria and the monitoring of their outcome increases trust in the function of remuneration scheme. As unambiguously measurable financial and non-financial performance and result criteria as possible should be used as basis for remuneration. The incentive effect of remuneration on long-term results may be promoted with vesting and engagement periods that may even cover several years.

It is usually the organ that has elected a person that decides on his or her remuneration. The general meeting decides on the remuneration of the board. As the board appoints the managing director, it usually decides on his or her remuneration. As for the other executives, the company shall define the decision-making order. The company may, for instance, apply the ‘one-over-one’ principle, according to which the board shall appoint the subordinates of the managing director and approve their goals as well as salary and remuneration principles.

If the company has a broader ownership base, the holdings of the directors in the company may promote good corporate governance. One good way of increasing the directors’
shareholding is to pay board fees partly or wholly in shares. The company may require that a director keep the shares that he or she has received as remuneration, or part of them, at least during board membership.

The payment of fixed remuneration as shares instead of cash deviates from share-based remuneration schemes, in which the size of the remuneration has not been defined in advance. Instead, it is defined on the basis of the company’s financial position or the development of the share value. The use of share-based remuneration schemes in the remuneration on external directors is, as a rule, not motivated with regard to the shareholders’ best interest. Participation in the same share-based remuneration scheme as the other executives or personnel may weaken the implementation of the board’s supervision obligation and lead to conflicts of interest.
Internal Control and Risk Management

The purpose of internal control and risk management is to ensure that the company operates efficiently and achieves good results, that information is reliable and that rules and operative principles are complied with. Internal control may facilitate the board’s fulfilment of its supervisory responsibilities.

Bearing in mind the size of the company, is its internal control and supervision organised so that the company operates effectively, achieves good results and so that information is reliable? Has the company defined the operative principles for internal control? Is there regular monitoring so that internal control is efficient? How is the company’s internal financial reporting organised?

The board of directors and the managing director are responsible for ensuring that the company operates in compliance with the law and the articles of association. For this purpose, the board of directors may for example determine the principles of internal control and monitor compliance with those principles. The distribution of tasks in small companies may result in so-called dangerous work combinations, where only a few persons take care of financial administration. Such a situation may be compensated by sufficient monitoring by the management and with reporting systems. Furthermore, such systems may facilitate the board of directors’ supervisory tasks. The organisation of the company’s internal control, if any, and its operations depend, e.g. on the nature and scope of company’s business, its geographical scope, the number of employees, and other similar factors.

Has the company established effective principles for internal control, taking into account the nature and size of the company? Are the risk management methods sufficient? Has the company paid attention to strategic risks?

Risk management is one aspect of the company’s control system. The purpose of risk management is to ensure that risks affecting the company’s business are identified and monitored. Such risks may relate to, for example decision-making, the company’s products, financing, competition, personnel, environment-related matters, contracts, and liabilities. Risk management should also take into account possible information security threats as well as the requirements on handling personal data.

Well-functioning risk management requires the definition of risk management principles. Through comprehensive risk management the company may achieve its desired total risk level in relation to the company’s ability to assume risks so that the continuity of business is not jeopardised.
Auditors play an important role in the company because they act as the supervisory organ appointed by the shareholders. Auditors provide shareholders with an independent written report on how the company’s accounts, financial statements and administration have been managed. The audit of the company’s administration covers its compliance with the law, but not the appropriateness of the operations. This means that auditors do not take a view on business decisions.

How is the auditors’ independence secured? Are shareholders sufficiently well informed of auditor candidates before the general meeting?

The law stipulates that the auditors shall be independent of the company and of its organs. If either the auditor or some member of his or her family is an official or an employee of the company, the auditor is disqualified. Auditors must also fulfil the competence requirements stipulated by law.

The shareholders’ decision-making when electing auditors may be facilitated by providing information on the auditor candidates well in advance of the general meeting.

Small companies do not have to elect an auditor. The company does not have to elect an auditor, if no more than one of the requirements below is fulfilled:

1. the balance sheet total exceeds 100 000 euros
2. the net sales exceed 200 000 euros or
3. the company employs more than three persons on an average.

Even though the election of an auditor were not necessary according to law, it is possible that an audit is the precondition of financing.
A shareholders’ agreement is an agreement concluded by the shareholders concerning the administration of the company and the conduct of its business. Parties to the agreement may be either some or all shareholders. A shareholders’ agreement may cover subjects that are not mandatory by virtue of the Limited Liability Companies Act or in conflict with the articles of association.

Could a shareholders’ agreement improve the predictability of decision-making in the company? Do the articles of association contain provisions that could, instead, be included in a shareholders’ agreement?

The shareholders’ agreement is binding for its parties. Concluding such an agreement could be more convenient than including the question in the articles of association. It may be more difficult to amend the articles of association than the shareholders’ agreement. Compliance with the shareholders’ agreement could be ensured, for example by including provisions on contractual penalties. The shareholders’ agreement is often confidential.

Has the company reflected on situations where a shareholders’ agreement could be useful for improving the predictability of corporate decision making?

A shareholders’ agreement could be useful for example in the following cases:
- protecting minority shareholders,
- in a company where several shareholders hold equal numbers of shares,
- in a company financed by equity investors,
- in generation changes.

A shareholders’ agreement could contain provisions on, e.g. the purpose and objectives of the company’ business, on seats on the board of directors and on the distribution of dividends. The agreement could also contain clauses on voting, first refusal clauses, redemption, and approval clauses. A competition prohibition may be used to make sure that the shareholders do not compete with the business conducted by the company. It is also possible to agree on the decision-making procedure in major financial decisions through a shareholders’ agreement.
Redemption and Approval Clauses

The assignment of the company’s shares to external parties can be limited by means of redemption clauses. They can serve the purpose of giving shareholders, the company itself, or other persons, the opportunity to redeem assigned shares so that other parties cannot interfere. The articles of association may contain a redemption clause. The clause shall establish the persons who are entitled to redemption and how the order of priority between them is defined. Through an approval clause, the company can control the number of shareholders.

Shareholders can control the assignment of shares to new owners by means of a redemption clause. Such a clause permits the restriction of access to the company by new shareholders and the maintenance of the internal power balance of the present shareholders. A redemption clause can cover all kinds of share assignments, or it can be more restricted so as not to cover, for example, inheritance. A clearly drafted redemption clause may reduce disputes.

If an approval clause is included on the company’s articles of association, the transferee may not exercise his or her votes in the company before having obtained the approval of the company for acquiring the shares. The articles of association may contain provisions for determining whether such approval is granted by the company’s board of directors or the general meeting. If the articles of association contain both redemption and approval clauses, their internal relation shall be defined.

Is there a need to restrict free trade with the company’s shares, or to restrict the assignment of shares to non-shareholders? Does the redemption clause include sales, as well as donations, inheritance, and distribution of matrimonial assets, or does the company wish to exclude certain forms of acquisition from the scope of the redemption clause? Does the redemption clause serve the shareholders’ present needs?
Good corporate governance requires reliable and sufficient distribution of information by the company. On the basis of such information, the shareholders are in a position to evaluate the company’s business and to make decisions in respect of their holdings. The company’s website is a good channel for providing up-to-date information to interest groups.

Does the company provide its shareholders with sufficient information about its business? Do they get the necessary information about the company and the work of the board of directors from the annual report, or in some other manner? Are shareholders informed of the essential personal data and company shareholdings of the directors and the managing director?

A clear presentation of matters concerning the company’s corporate governance system enables the shareholders to form a comprehensive picture of the company’s operations. The company’s corporate governance system can be presented in the annual report, or in some other manner.

A good annual report is informative, individual subjects are clearly defined and they can easily be found. Publication of financial key figures may increase the shareholders’ confidence in the company.

Shareholders can be informed of the work of the board of directors by publishing, either in the annual report or in some other manner, for example the number of board meetings and participation in them.

Shareholders get information about the directors and the managing director, if their personal data are published either in the annual report or in some other manner. Such data may include the following, for instance:

- name
- year of birth
- education and training
- main occupation
- essential working experience
- date of election to the board of directors
- most important simultaneous positions of trust
- shareholdings in the company
- holdings and rights based on share-based remuneration schemes of the company.
On the basis of the information about the directors, the shareholders are able to evaluate the directors' competence and relation with the company.

**Does the company need to provide its interest groups with information about the company's business? Can interest groups easily find information about the company?**

On the basis of its own needs and starting points, the company may decide how and to what extent it will inform its other interest groups about its business. The use of the Internet as a communications channel increases awareness of the company and may improve the distribution of information to interest groups. It is easier to update information in electronic format than paper bulletins. Thus, the interest groups get the latest news about the company. The quality, clarity and topicality of the information are often more important than the amount of information.
A generation change in family-owned companies has important consequences for corporate governance. A generation change takes time and must be carefully planned. It is a complicated process, where the transfer of experience and expertise to the follower must be prepared. Matters related to financial, family, inheritance and tax law must also be taken into account.

Have preparations been made in respect of a possible future generation change? Are members of the next generation aware of plans and decisions made in view of the generation change? Has the company considered how and on what terms family members shall be involved and initiated in the company business? How has the company taken into consideration the major interest groups when planning the generation change? Does the company have a plan in case no successor can be found?

Bearing in mind the size of the company, the owners of family-owned companies should create a strong team with a clear distribution of tasks and responsibilities for preparing generation change. The chairman of the board may be the right person to co-ordinate the planning and implementation of the generation change procedure. Owners of family-owned companies should go through plans and decisions related to a generation change as well as other essential decisions in advance with the next generation as well. In bigger family-owned companies, it may be appropriate to establish clear rules in respect of the principles for including family members in the company.

It is important that the person who will continue with the company operations understands the business as a whole. Communicating the fact that the successor is able to take care of the long-term relations will increase the trust of the interest groups in the continuity of the company business.

If no successor can be found for a viable company within the family, preparations for selling the company must be initiated sufficiently in advance. In this case, the sale of the company or its business operations should be set as a goal and included in the company strategy.
Family council in a family-owned company

When ownership is divided between different family members or families, it may be appropriate to establish a separate family council, which will gather the owners. The family council identifies and defines the owners’ ambition. The family’s ambition, owner policy, may be written down and all shareholders, the board of directors and executive management may be informed of it. The family council is not a decision-making body. It may also act as a forum through which family traditions within the company are transferred to next generations.

As the number of shareholders in a family-owned company increases (usually in the third generation), attention should be paid to the information flow between the family members. A family council, which may include all shareholders within the family who are of age, may annually gather the family members to hear about the company business and discuss it.

A family council concentrates on matters related to shareholders that are not handled at general meetings. The family council defines the owners’ vision and strategic direction and informs the board of directors of them. The family council should not interfere with the actual business operations. It may, e.g. go through the matters that have taken place within the company and prepare the election of directors. In some companies, a family council has established a nomination committee for the election of directors, and in other cases the family council proposes for the general meeting the members to be elected to the nomination committee.

A family council may also act as a discussion forum with the task of distributing information and maintaining interaction, engaging, transferring tradition and maintaining the unity of the family. A separate council may also be established for these purposes.

Does the company have owners in several generations or branches of the family? How are the values of the family and owner policy communicated to younger generations? Do all owners have a similar view on the future of the company? Is the company management aware of the owners’ views?
Social Responsibility

The social responsibility of companies means the balanced development and management of environmental, social and financial factors in co-operation with interest groups. A responsible company is managed consistently in the long term, the work supports the business operations, and the areas emphasised are defined by the company. Responsible operations are a strategic means for an SME to improve its competitiveness.

Has the company defined the important areas of social responsibility with regard to its own business?

Social responsibility means that the company has voluntarily taken into consideration such financial, social and environmental aspects that can guarantee sustainable development. When a company invests in corporate responsibility with regard to both the interests of society and the productivity of the company, this may lead to new innovations and give the company a competitive edge. In order to manage responsibility so that it provides added value, a company must define for its own business the central aspects of corporate and social responsibility and decide on its operations regarding them. For a company, responsible operations mean continuous development, monitoring of operations and improvement of processes. Corporate responsibility is accentuated when an SME is part of a delivery chain. Large companies often place requirements on responsibility in their procurement contracts.

When we talk about corporate and social responsibility, the main emphasis is often on responsibility reporting. SMEs cannot, however, be required to draw up extensive responsibility reports. It is more essential that responsible operations are part of the day-to-day business and its foundation. It must be possible for SMEs to develop corporate responsibility reporting from their own starting points.