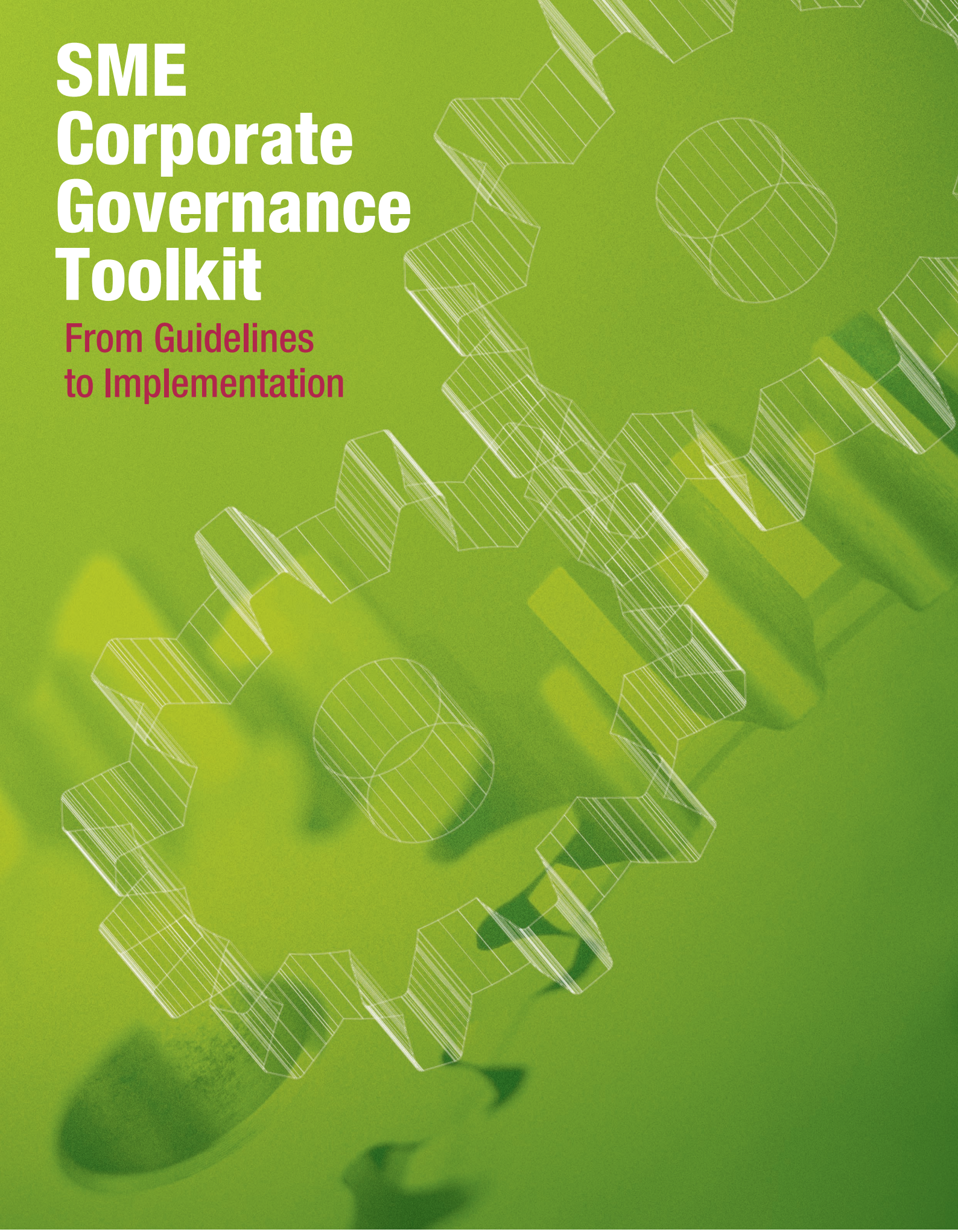
# SME Corporate Governance Toolkit

## From Guidelines to Implementation



Organizer

香港董事學會 The Hong Kong Institute of Directors

Implementation Agent

Hong Kong Productivity Council 香港生產力促進局

Funded by

工業貿易署 Trade and Industry Department

Funded by the SME Development Fund of the Trade and Industry Department, HKSAR Government

Sponsored by

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This publication, *SME Corporate Governance Toolkit – From Guidelines to Implementation* ("Toolkit"), was created and published by The Hong Kong Institute of Directors ("HKIoD") as a follow-up to the HKIoD guidebook, *Guidelines on Corporate Governance for SMEs in Hong Kong* ("Guidelines"), to facilitate SMEs in the implementation of corporate governance practices. While the Guidelines address the "what-to-do" aspects of corporate governance practices, the Toolkit covers the "how-to-do" steps of implementation. It is recommended that both the Guidelines and the Toolkit are read as complementary reference tools for SMEs.

This Toolkit is the product of a 30-month project, developed with the consolidation of input from experiences, expertise and insights of the Author, the Organizing Committee and Editorial Board, eight speakers and over 1,000 participants of three Awareness Seminars and three Workshops as well as 10 Pilotee SMEs guided by 20 Coaches in a Pilot Programme. In addition, a Finale Conference of the project was held for experience sharing by the Pilotees and Coaches with over 300 SMEs. The promotion of and education on corporate governance among SMEs will continue beyond the publication of this Toolkit.

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01 Enterprises Ltd • The Brighter Company
Cableplus Industrial Company Ltd • Charlotte Travel Ltd
Impulse International Enterprises Ltd • JDI Company Ltd
My Dear Floral and Wedding Services • Pacific Sky Industries Ltd
Professional Security Services Ltd • Zenith Cosmetics Trading Company Ltd

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The Hong Kong Institute of Directors ("HKIoD") is Hong Kong's premier body representing directors to foster the long-term success of companies through advocacy and standards-setting in corporate governance and professional development for directors. A non-profit-distributing organisation with membership consisting of directors from listed and non-listed companies, HKIoD is committed to providing directors with educational programmes and information service and establishing an influential voice in representing directors. With international perspectives and a multi-cultural environment, HKIoD conducts business in biliteracy and trilingualism.

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Any opinions, findings, conclusions or recommendations expressed in this publication do not reflect the views of the Government of the Hong Kong Special Administrative Region, Trade and Industry Department or the Vetting Committee for the SME Development Fund.

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# The Hong Kong Institute of Directors

# Corporate Governance Toolkit

# Establish Board of Directors and Committees

Reference and page number in "Guidelines on corporate Governance for SMEs in Hong Kong"

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| 1.6.3 | 13 | The concept of corporate governance and its importance → International Developments |
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Management practice cycle ("Guidelines on corporate Governance for SMEs in Hong Kong" page 8)

| **Cycle Number** | **Management practice cycle** |
|---|---|
| 1 | Planning |
| 4 | Organising |
| 5 | Leading |
| 6 | Controlling |

## 1. Overview

Expectation in good corporate governance from stakeholders has placed increase focus on the effective role and operation of the board of directors (the "Board"). The Board appointed by shareholders, is responsible to direct, manage and govern the operation of the company. Clearly defining the roles and responsibilities of directors, establish board committees (e.g. Audit Committee, Remuneration Committee and Nomination Committee) to govern specific function, conduct regular Board meeting, develop ongoing dialogue with shareholders and perform regular evaluation on Board performance will maximize the possibilities of achieving an organization's objectives as well as enhance the value of shareholders.

For SMEs, it is often noted that management and governance power are relatively centralized, establishing an multi-disciplined and independent Board can balance the interests of shareholders and those of the management and resolve potential conflicts among family members and non-family members in the company. In addition, establishment of a Board can enhance the corporate governance structure and practice for SMEs to meet with their growth challenges.

## 2. What You Can Do

**2.1. Establish the Board.** Depending on the complexity of the industry, size of the company and requirements of stakeholders, the Board could determine the need to have a combination of internal and external board members in order to enhance the separation of ownership and management of the company, Directors that are independent are often referred to as Non-Executive Director (the "NED") or Independent Non-Executive Director (the "INED"). NED or INED is a person who is independent from the Chief Executive Officer ("CEO"), the management team, and the shareholders, i.e. he or she should be someone who is not an employee of the company and is not affiliated with any of the company's investors. Other considerations in appointment of Board members should include aspects such as their experiences (e.g. financial, legal, operational), cultural, social factors etc.

A chairman should be appointed to lead and manage the Board. The chairman should be elected by members of the Board. In more sizeable organizations, the role of chairman should be performed by an independent non-executive director. Some key responsibilities of the Chairman include:

- Acts as chair of all meetings of the Board and is ensuring that the Board meeting agenda enables the Board to successfully carry out its duties.
- Take necessary measures to create a climate of trust so to enable the Board to contribute to open discussion, constructive criticism and support for the decisions made by it.
- Stimulate effective interaction between the Board and the Board Committees. He or she should maintain a close relationship with the CEO and support and advise the latter, bearing in mind the CEO's executive responsibility.
- Reviews the composition and structure of the Board so to ensure a balance of skills and experiences are maintained.

**2.2. Define roles and responsibilities of the Board members.** To effectively lead and manage the company, the Board must delegate its authority and responsibility to management and the matters that reserved for Board should be clearly defined and documented.

The basic authority, roles and responsibilities of Board are normally defined in the company's Articles of Association. It is beneficial for the company to establish the terms of reference for the Board or develop the letter of appointment for director to clearly define the roles and responsibilities. Below are some sample roles and responsibilities of the Board:

- **Board and Committees of the Board**
  - Review the structure and adequacy of the Board and the Board Committees, and their respective terms of reference at least annually; and
  - Review the membership and effectiveness of its Committees, e.g. Audit Committee, Nomination Committee and Remuneration Committee.
- **Laws and Regulations**
  - Ensure and monitor compliance with applicable laws and regulations; and
  - Ensure and monitor compliance of fiduciary duties.
- **Corporate Governance and Ethical Issues**
  - Ensure the company adheres to high standards of ethics and corporate governance
- **Mission, Strategy and Plans**
  - Participate in the development of, and ultimately approve the mission, vision and values of the company;
  - Review and approve the business strategies and plans proposed by the management of the company; and
  - Approve annual budget proposed by the management of the Company and other performance indicators against them and initiate corrective action, when required.
- **Policies and Procedures**
  - Approve and monitor compliance with all significant policies and procedures by which the company are operated; and
  - Review significant new policies and procedures or material amendments to existing policies and procedures.

- **Risk, Internal Controls and Financial Issues**
    - Ensure the risks facing by the company have been identified, assessed and that the risks are being properly managed;
    - Ensure that the company maintains sound and effective internal controls to safeguard the shareholders' investment and the company's assets;
    - Ensure that the company's financial statements are true and fair and otherwise confirm with applicable laws and regulations;
    - Ensure timely and balanced disclosure of all material matters concerning the company;
    - Approve interim and annual financial statements; and
    - Approve the appointment of external auditors.
- **Human Resources**
    - Approve the appointment of CEO and senior management;
    - Approve the roles and responsibilities of the CEO and senior management;
    - Approve the remuneration package of CEO and senior management; and
    - Review the CEO performance at least annually, against agreed upon annual objectives.
- **Business Operations**
    - Approve new business initiatives, significant investments and capital expenditures.

To familiar members of the Board with their roles and responsibilities, an induction program could be provided for all new directors. The induction program should include director's roles and responsibilities and information in relation to the company's operations and business structure so that new directors could fully understand their roles and duties. Continuous professional development program should be arranged to develop and refresh director's knowledge and skills so as to maintain the Board effectiveness.

**2.3. Establish Board Committees.** Board committees reporting to the Board and are established to be responsible for specific governance issues. Independence of board committees would be enhanced if the board committees are chaired by INED. The board committees should include but not be limited to (1) audit committee; (2) remuneration/compensation committee; (3) nomination committee and (4) other committees.

- **Audit Committee.** An independent audit committee permits greater assurance as to the accuracy of the financial statements and their compliance with applied accounting principle. The audit committee should consist of only NED and INED and at least one of the members should possess appropriate professional qualifications or accounting or related financial management expertise. Below are some sample roles and responsibilities of audit committee:

    - Ensure that appropriate accounting principles and reporting practices are adopted and followed by the company;
    - Approve the scope of work of external auditors and internal auditors;
    - Select and approve the appointment of external auditor;
    - Review and provide comments of the draft interim and annual accounts before presenting to the Board for approval;
    - Ensure that internal controls are in place to mitigate the risks faced by the company;
    - Review the risk management function of the company;
    - Provide liaison among the shareholders, management, the external auditor and internal auditor; and
    - Satisfy itself as to compliance with any applicable legal requirements.

- **Remuneration Committee.** The Board should establish a remuneration committee to responsible for the review of remuneration policy and package of directors and senior management. Majority of the members of the remuneration committee should be INED who could provide objective evaluation and advice on external market trends and industrial remuneration policy for comparison. Below are some sample roles and responsibilities of the remuneration committee:

    - Make recommendations to the Board on policy and structure for all remuneration of directors and senior management and on the establishment of a formal and transparent procedure for developing policy on such remuneration;
    - Make recommendations to the Board on the remuneration package of directors and senior management;
    - Review and approve performance-based remuneration by reference to corporate goals and objectives;
    - Review and approve compensation payable to executive directors and senior management in connection with any loss or termination of their office or appointment;
    - Review and approve compensation arrangement relating to dismissal or removal of directors for misconduct; and
    - Ensure that no director or any of his/her associates is involved in deciding his/her remuneration.

- **Nomination Committee.** The Board should consider the establishment of nomination committee to responsible for the nomination of new directors and evaluation of existing Board structure. A majority of the members of the nomination committee should be INED. The nomination committee should responsible for the duties as follows:

    - Review the structure, size and composition of the board on a regular basis and make recommendations to the board for any proposed changes;

    - Identify individuals suitably qualified to become board members and recommend for directorship;

    - Assess the independence of independent non-executive directors; and

    - Make recommendations to the board for appointment or re-appointment of directors and succession planning for directors and/or key senior management.

- **Other Committees.** Besides the three committees mentioned above, the Board should also consider establishing other committees, such as China Committee, Risk Management Committee, Business Development Committee, Social Environmental Committee, etc., according to the business nature and requirements of the company. The structure, roles and responsibilities of these committees should be clearly defined and their authority should be properly delegated by the Board.

**2.4. Develop terms of references for the Board and Board Committees.** Terms of reference summarizing the composition, roles, responsibilities and authority of the Board and each board committee should be established. The terms of reference should be reviewed and approved by the Board. Below are some key items that should be included in the terms of references:

- Objective of the Board or board committee;

- Composition of the Board or board committee, describing the structure, membership criteria and terms of office of the members;

- Authority, roles and responsibilities of the Board or board committee;

- Meeting and record keeping protocol, including the frequency, quorum and notice of meeting, appointment of secretary of meeting and the maintenance of meeting minutes and written resolutions.

The terms of reference should be reviewed and updated on a regular basis so as to reflect any changes in circumstances.

**2.5. Hold Board meetings.** Members of the Board should meet regularly to review company's performance, determine major business decisions and perform its fiduciary duties on the company. The Chairman of the Board should take a lead on Board meeting, such as authority to determine agenda, control the allocation of board's time in meetings, to require the provision of relevant information for Board consideration, to lead and manage the meeting and to review the draft minutes before it is distributed to other Board members.

- **Meeting frequency** – There is no statutory requirement on the minimum number of meetings to be held by the Board. A company normally defines the frequency and minimum number of Board meeting in its Articles of Association and Board terms of reference. Good practice calls for Board meetings to be held on a quarterly basis.

- **Forms** – Board meeting should be conducted in a way with active participation, including in person or through other electronic means of communication (e.g. telephone conference call, video conferencing), by all members.

- **Agenda** – Agenda of the Board meeting should be established and distributed to all members before the meeting. The Chairman and the company secretary should coordinate to determine the priority and items to be included in the agenda. The agenda should be sent to the members with sufficient time to review and propose additional issues for discussion. In general, notice of at least 14 days would be considered as sufficient.

- **Board papers** – To enhance efficiency and effectiveness of Board meeting, relevant background information in relation to agenda item, which is written in a form of board papers, should be provided to the Board for better understanding and decision making. Company should also establish a procedure for the ability of directors to require sufficient information from management or independent advisors so as to discharge their fiduciary duties.

- **Minutes** – Minutes of board meetings should record in sufficient detail the matters considered by the board and decisions reached, including any concerns raised by directors or dissenting views expressed. Draft minutes should be reviewed by the Chairman before distribution to all directors for review.

**2.6. Communicate with shareholders**

Board is accountable to the shareholders and it is the power of Board comes from. Communication (e.g. through the participation in annual general meeting) should be maintained between the Board and shareholders in order to discharge its duties. Procedures should be in place to enable shareholders to be informed of significant matters in relation to the company. This is especially important for those companies with several shareholders who are not directly involved in the executive management of the company's operations.

### 2.7. Evaluate the Board performance

To enhance the overall quality of Board performance and determine the effectiveness of achievement of the Board objective, it is beneficial for the Board to conduct annual evaluation on the Board and board committee performance. The scope and approach of evaluation could be varied depending on the preference and needs of the company. The performance evaluation can be performed by having self-assessment, peer evaluation or evaluation conducted by external advisor. Results of the evaluation should be shared with the Board. The Chairman should act on the results of the evaluation to further improve the Board's performance.

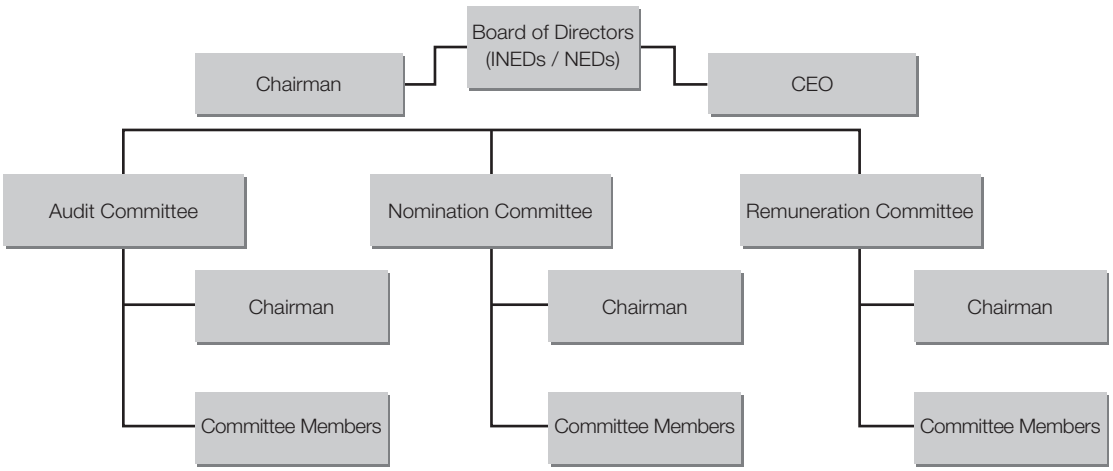
## 3. Benefits/Limitations

**3.1. Benefits.** The establishment of Board and relevant Board committees is beneficial for promoting sound corporate governance. Given the fact that the Board serves as the bridge connecting the body of shareholders and management, high ethical Board body and clearly designated Board responsibility support the independence between designation and execution. In addition, a competent Board prepares the company that consider going public to comply with listing requirements and regulations and therefore saves related costs in the long run.

**3.2. Limitations.** For SMEs the potential costs for establishing and managing an effective Board and Board committees could impair the long-term benefits derived from a structured Board of directors considering their business sizes and financial concerns. The involvement of INEDs or NEDs to the Board and committees in SMEs will be limited by their financial ability as well which could impair their independent function.

## 4. Tools, Templates and Illustrations

**Illustration 4.1: Board and Board Committee Structure**



### Illustration 4.2: Sample Audit Committee Terms of Reference

**1. Membership**

1.1 Members of the Committee shall be appointed by the board, on the recommendation of the Nomination Committee in consultation with the Chairman of the Audit Committee. The Committee shall be made up of at least three members.

1.2 All members of the Committee shall be independent nonexecutive directors. At least one of whom shall have recent and relevant financial experience. The Chairman of the board shall not be a member of the Committee.

1.3 Only members of the Committee have the right to attend Committee meetings. However, other individuals such as the Chairman of the board, Chief Executive, Finance Director, other directors, the heads of risk, compliance and internal audit and representatives from the finance function may be invited to attend all or part of any meeting as and when appropriate.

1.4 The external auditors will be invited to attend meetings of the Committee on a regular basis.

1.5 Appointments to the Committee shall be for a period of up to three years, which may be extended for two further three year periods, provided the director remains independent.

1.6 The board shall appoint the Committee Chairman who shall be an independent non-executive director. In the absence of the Committee Chairman and/or an appointed deputy, the remaining members present shall elect one of themselves to chair the meeting.

**2. Secretary**

The company secretary or their nominee shall act as the secretary of the Committee.

**3. Quorum**

The quorum necessary for the transaction of business shall be members. A duly convened meeting of the Committee at which a quorum is present shall be competent to exercise all or any of the authorities, powers and discretions vested in or exercisable by the Committee.

**4. Frequency of Meetings**

The Committee shall meet at least three times a year at appropriate times in the reporting and audit cycle [quarterly on the first Wednesday in each of January, April, July and October] and otherwise as required.

The frequency and timing of meetings will differ according to the needs of the company. Meetings should be organised so that attendance is maximised (for example by timetabling them to coincide with board meetings).

## 5. Notice of Meetings

5.1 Meetings of the Committee shall be summoned by the secretary of the Committee at the request of any of its members or at the request of external or internal auditors if they consider it necessary.

5.2 Unless otherwise agreed, notice of each meeting confirming the venue, time and date together with an agenda of items to be discussed, shall be forwarded to each member of the Committee, any other person required to attend and all other non-executive directors, no later than 14 working days before the date of the meeting. Supporting papers shall be sent to Committee members and to other attendees as appropriate, at the same time.

## 6. Minutes of Meetings

6.1 The secretary shall minute the proceedings and resolutions of all meetings of the Committee, including recording the names of those present and in attendance.

6.2 The secretary shall ascertain, at the beginning of each meeting, the existence of any conflicts of interest and minute them accordingly.

6.3 Minutes of Committee meetings shall be circulated promptly to all members of the Committee and, once agreed, to all members of the board.

## 7. Annual General Meeting

The Chairman of the Committee shall attend the Annual General Meeting and prepare to respond to any shareholder questions on the Committee's activities.

## 8. Duties

The Committee should carry out the duties below for the parent company, major subsidiary undertakings and the group as a whole, as appropriate.

### 8.1 Financial Reporting

8.1.1 The Committee shall monitor the integrity of the financial statements of the company, including its annual and interim reports, preliminary results' announcements and any other formal announcement relating to its financial performance, reviewing significant financial reporting issues and judgments which they contain. The Committee shall also review summary financial statements, significant financial returns to regulators and any financial information contained in certain other documents, such as announcements of a price sensitive nature.

8.1.2 The Committee shall review and challenge where necessary:

8.1.2.1 the consistency of, and any changes to, accounting policies both on a year on year basis and across the company/group;

8.1.2.2 the methods used to account for significant or unusual transactions where different approaches are possible;

8.1.2.3 whether the company has followed appropriate accounting standards and made appropriate estimates and judgments, taking into account the views of the external auditor;

8.1.2.4 the clarity of disclosure in the company's financial reports and the context in which statements are made; and

8.1.2.5 all material information presented with the financial statements, such as the operating and financial review and the corporate governance statement (insofar as it relates to the audit and risk management);

8.1.3 The Committee shall review the annual financial statements of the pension funds where not reviewed by the board as a whole.

### 8.2 Internal Controls and Risk Management Systems

The Committee shall:

8.2.1 keep under review the effectiveness of the company's internal controls and risk management systems;

8.2.2 review and approve the statements to be included in the annual report concerning internal controls and risk management.

### 8.3 Whistle blowing

The Committee shall review the company's arrangements for its employees to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters. The Committee shall ensure that these arrangements allow proportionate and independent investigation of such matters and appropriate follow up action.

### 8.4 Internal Audit

The Committee shall:

8.4.1 monitor and review the effectiveness of the company's internal audit function in the context of the company's overall risk management system;

8.4.2 approve the appointment and removal of the head of the internal audit function;

8.4.3 consider and approve the remit of the internal audit function and ensure it has adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards. The Committee shall also ensure the function has adequate standing and is free from management or other restrictions;

8.4.4 review and assess the annual internal audit plan;

8.4.5 review promptly all reports on the company from the internal auditors;

8.4.6 review and monitor management's responsiveness to the findings and recommendations of the internal auditor; and

8.4.7 meet the head of internal audit at least once a year, without management being present, to discuss their concerns and any issues arising from the internal audits carried out. In addition, the head of internal audit shall be given the right of direct access to the Chairman of the board and to the Committee.

### 8.5 External Audit

The Committee shall:

8.5.1 consider and make recommendations to the board, to be put to shareholders for approval at the AGM, in relation to the appointment, re-appointment and removal of the company's external auditor. The Committee shall oversee the selection process for new auditors and if an auditor resigns the Committee shall investigate the issues leading to this and decide whether any action is required;

8.5.2 oversee the relationship with the external auditor including (but not limited to):

8.5.2.1 approval of their remuneration, whether fees for audit or non-audit services and that the level of fees is appropriate to enable an adequate audit to be conducted;

8.5.2.2 approval of their terms of engagement, including any engagement letter issued at the start of each audit and the scope of the audit;

8.5.2.3 assessing annually their independence and objectivity taking into account relevant professional and regulatory requirements and the relationship with the auditor as a whole, including the provision of any non-audit services;

8.5.2.4 satisfying itself that there are no relationships (such as family, employment, investment, financial or business) between the auditor and the company (other than in the ordinary course of business);

8.5.2.5 agreeing with the board a policy on the employment of former employees of the company's auditor, then monitoring the implementation of this policy;

8.5.2.6 monitoring the auditor's compliance with relevant ethical and professional guidance on the rotation of audit partners, the level of fees paid by the company compared to the overall fee income of the firm, office and partner and other related requirements;

8.5.2.7 assessing annually their qualifications, expertise and resources and the effectiveness of the audit process which shall include a report from the external auditor on their own internal quality procedures;

8.5.3 meet regularly with the external auditor, including once at the planning stage before the audit and once after the audit at the reporting stage. The Committee shall meet the external auditor at least once a year, without management being present, to discuss their concerns and any issues arising from the audit;

8.5.4 review and approve the annual audit plan and ensure that it is consistent with the scope of the audit engagement;

8.5.5 review the findings of the audit with the external auditor. This shall include but not be limited to, the following;

8.5.5.1 a discussion of any major issues which arose during the audit,

8.5.5.2 any accounting and audit judgments,

8.5.5.3 levels of errors identified during the audit.

**The Committee shall also review the effectiveness of the audit.**

8.5.6 review any representation letter(s) requested by the external auditor before they are signed by management;

8.5.7 review the management letter and management's response to the auditor's findings and recommendations;

8.5.8 develop and implement a policy on the supply of non-audit services by the external auditor, taking into account any relevant ethical guidance on the matter.

**8.6 Reporting Responsibilities**

8.6.1 The Committee Chairman shall report formally to the board on its proceedings after each meeting on all matters within its duties and responsibilities.

8.6.2 The Committee shall make whatever recommendations to the board it deems appropriate on any area within its responsibilities where action or improvement is needed.

8.6.3 The Committee shall compile a report to shareholders on its activities to be included in the company's annual report.

**8.7 Other Matters**

The Committee shall:

8.7.1 have access to sufficient resources in order to carry out its duties, including access to the company secretariat for assistance as required;

8.7.2 be provided with appropriate and timely training, both in the form of an induction programme for new members and on an ongoing basis for all members;

8.7.3 give due consideration to laws and regulations, the provisions of the Combined Code and the requirements of the UK Listing Authority's Listing Rules as appropriate;

8.7.4 be responsible for co-ordination of the internal and external auditors;

8.7.5 oversee any investigation of activities which are within its terms of reference and act as a court of the last resort;

8.7.6 at least once a year, review its own performance, constitution and terms of reference to ensure it is operating at maximum effectiveness and recommend any changes it considers necessary to the board for approval.

**9. Authority**

The Committee is authorised:

9.1 to seek any information it requires from any employee of the company in order to perform its duties;

9.2 to obtain, at the company's expense, outside legal or other professional advice on any matter within its terms of reference; and

9.3 to call any employee to be questioned

### Template 4.3: Meeting Summary Sheet Template

Company Name: _____

Year: 20 _____

Type of Meeting: ☐ Annual/Regular or ☐ Special

Meeting of: ☐ Directors or ☐ Shareholders

Date: _____ , 20 _____ Time: _____

Place: _____

Meeting Called by: _____

Purpose: _____

_____

Committee or Other Reports or Presentations: _____

Other Reminders or Notes: _____

Notice Required: ☐ Written ☐ Verbal ☐ Not Required

Notice Must Be Given by Date: _____

Notice of Meeting Given to:

| Name | Type of Notice | Location or Phone Number | Date Notice Given | Date Acknowledged Receipt |
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* Types of Notice: written (mailed, hand-delivered); verbal (in person, telephone conversation, answering machine, voice mail); email; fax.

## 5. Further Reading/References


- "Guide for Independent Non-Executive Directors." The Hong Kong Institute of Directors Ltd. September 2003, 2nd Edition.

- Martin Lipton. "Some Thoughts for Boards of Directors of 2007." December, 2006.

- Frederick D. Lipman and L.Keith Lipman. "Corporate Governance Best Practices: Strategies for Public, Private, and Not-for-Profit Organizations." 2006.

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# The Hong Kong Institute of Directors

# Corporate Governance Toolkit

# Develop the Right Corporate Culture and Leadership Style

Reference and page number in “Guidelines on corporate Governance for SMEs in Hong Kong”

| **Reference number** | **Page** | **Title → subtitle in Guidelines** |
|---|---|---|
| 4.6 | 52 | Management practice guidelines → Leading |

Management practice cycle (“Guidelines on corporate Governance for SMEs in Hong Kong” page 8)

| **Cycle Number** | **Management practice cycle** |
|---|---|
| 5 | Leading |

## 1. Overview

The right corporate culture and strong leadership is an essential building block for success. This is particularly true for the case of SMEs, since growth causes a company's organizational complexity to increase, which creates a strong demand for effective leaders who will efficiently adapt and react to change. However, it is common for many companies to neglect culture and leadership development. Many companies are often over-managed and under-led. Management processes are often focused on the short-term and do not always reflects a company's long-term objectives.

Reorganizing and redirecting leaders can be a challenging aspect of a company's growth. Establishing the appropriate set of leaders can be difficult due to existing levels of management, changing needs and requirements, and lack of resources and time to address leadership issues. Nevertheless, companies should make it a priority to identify their corporate culture and leadership needs and develop leadership talent in order to support the growth of the company.

## 2. What You Can Do

**2.1. Recognise your requirements.** For an organization to establish a strong foundation of leadership, a distinction must first be made between managers and leaders. Leadership is to bring about movement or change. The core process of leadership is to establish long-term direction and aligning resources to achieve the goals. Whereas management focuses on maintaining order and consistency. The roles of management are to perform planning and budgeting on a shorter timeframe, organizing resources to perform the right job. (For the key differences between leadership and management, please refer to Illustration 4.1 for detail). Finding the appropriate leadership and management combination helps companies maintain key priorities as they scale their operations. When a company expands, it will undergo a great amount of change and at the same time the complexity of organization will increase. As a result, growth companies need leaders who can embrace uncertainty, set direction, and inspire others to follow and also these companies need strong management to plan and focus on execution. In conclusion, it is essential for companies to identify their appropriate mix of leadership and management. (For the detail leadership and management requirements for the growth of company, please refer to Illustration 4.2).

**2.2. Making leaders more effective.** After understanding the leadership requirements of the company, management should further determine the roles and style of leadership that make the leaders more effective.

- **Recognise the roles of leadership.** The roles of leadership are different as a company moves along the growth curve. For a start-up business, leaders will usually take part in all business activities and responsible for virtually every major decision. When a company grows, the size of the company will expand and tend to have more leaders specializing in different roles, such as communication, team-building and developing strategy. (For details, please refer to Illustration 4.3)

- **Understand leadership style options.** After a company has identified the type of leadership it requires, the next step is to determine the suitable leadership style that is best suited. Seven major types of leadership are depicted as follows:

    - **General.** It is characterized by explicit commanding. It is more appropriate for companies in which decisions need to be made fast and when the input of the employees is not needed. However, employees tend to be resentful and demoralized. This style is common in military operations or company with extreme turnarounds.

    - **Autocrat.** This type of leader dominates team members using unilateralism to achieve a singular objective. There is usually passive resistance from the employees and the leader needs to continuously pressure employees to get the job done. This may be appropriate when action is required relatively fast and when the followers prefer such style. Companies that turnaround situations are suitable to apply this style.

    - **Technocrat.** This style is exercised through use of knowledge, expert power, and the ability to solve relevant problems. This makes employees heavily reliant on their leader. This may be appropriate when most of the employees of the company are knowledgeable in one specific technical field. Small high-tech companies tend to use this kind of style.

    - **Charismatic.** This leader uses superior interpersonal skills and "likeability" to control and influence. Subsequently, the employees are enthusiastic and eager to perform, but they may also be easily disillusioned if trust is broken or the tasks get difficult. This may be appropriate when the direction of the company is not clearly defined. Companies with high-profile management incline to apply this style

    - **Consultative democrat.** This leader has confidence and trust in most employees and communicates and consults substantially with employees, but makes all final decisions. In that sense, employees become empowered and motivated, but they might be disillusioned if the results of the consultative process are not considered in the final decisions. This may be appropriate when the input from the employees is highly valuable. This leadership style is very common nowadays.

    - **Participatory democrat.** It takes place when a leader gathers a group of employees to meet and discuss the best solution to an issue the company might be facing, and the final decision is agreed by the group and not by an individual. There may not be an explicit leader. It follows that employees are empowered and motivated, but decisions usually take longer and sometimes may lead to an impasse. This may be appropriate when employees have built trust with one another and produced previous good results and when there is not an absolute leader in the team. This leadership style exists but is very rare.

- **Laissez-faire.** This leader exercises little control over the group, leaving them to sort out their roles and to carry out their duties and responsibilities without participating in the process. This is the type of leadership that provides the most empowerment and motivation under the right circumstances, but it may also provide little or no direction for common goals. It may be appropriate when the employees are motivated and highly skilled and when the employees have produced excellent work in the past. This leadership style exists but is not very common nowadays.

- **Develop the leadership team.** After determining the leadership role and appropriate style, management should set up the leadership development process. The first step is to select the appropriate candidates who have the most talent and innate leadership qualities as well as an ability to learn. The selected candidates should be developed through mentoring, coaching and learning from other leaders.

**2.3. Determine the most appropriate style for your company.** There are a number of issues as well as internal and external factors that management needs to consider before deciding which leadership style fits in the company best, e.g. the supervision and control required by the employees of the company, the economic climate in which the company operates, the complexity of laws and regulations and the urgency of the tasks the company needs to carry out. The operating styles of SMEs vary significantly from one to the other. A company with 5 employees that operates in the service industry would probably not obtain the best results applying the same leadership style used by a company with 90 employees that operates in the manufacturing industry.

## 3. Benefits/Limitations

**3.3. Benefits.** Developing the right leadership is a critical success factor, which enables a company to grow effectively. The right leadership will help a company dealing with heightened competition as well as changing market demands.

**3.2. Limitations.** Leadership development is essentially an investment in the future. However, many companies find it difficult to develop leadership, which requires a lot of time and resources. A change in leadership style also brings a change of the company's culture. If improper change management is exercised, it will create disruptions to daily operations and affect employee morale.

## 4. Tools, Templates, Illustration

**Illustration 4.1: Key Difference between Leadership and Management**

| | Leadership | Management |
|---|---|---|
| **Definition** | The art of influencing others to achieve their maximum performance in order to accomplish any tasks or objectives. | The science of obtaining results through the efforts of others. |
| **Objective** | Generate valuable and essential change | Produce consistency and other |
| **The core process** | • Establish direction<br>  • Long timeframes<br>  • Big picture<br>  • Calculated risks<br>• Aligning people<br>  • Integration of goals<br>  • Consensus-building<br>  • Commitment<br>• Motivating and inspiring<br>  • Empowers<br>  • Energises | • Planning and budgeting<br>  • Short timeframes<br>  • Details<br>  • Eliminating risks<br>• Organizing and staffing<br>  • Specialization<br>  • Right people for right job<br>  • Compliance<br>• Controlling and problem solving<br>  • Containment<br>  • Control<br>  • Predictability |
| **Result** | • Innovate<br>• Develop<br>• Inspire first<br>• Originate<br>• Eye the horizon<br>• Challenge the status quo | • Administrator and conform<br>• Maintain<br>• Rely on control<br>• Imitate<br>• Eye the bottom line<br>• Accept status quo |
| **Complete Process** | • Both decide what needs to be done<br>• Both put together networks of people to execute necessary plans<br>• Both have processes to ensure that those people actually get the job done | |

**Illustration 4.2: Leadership and Management Requirements**

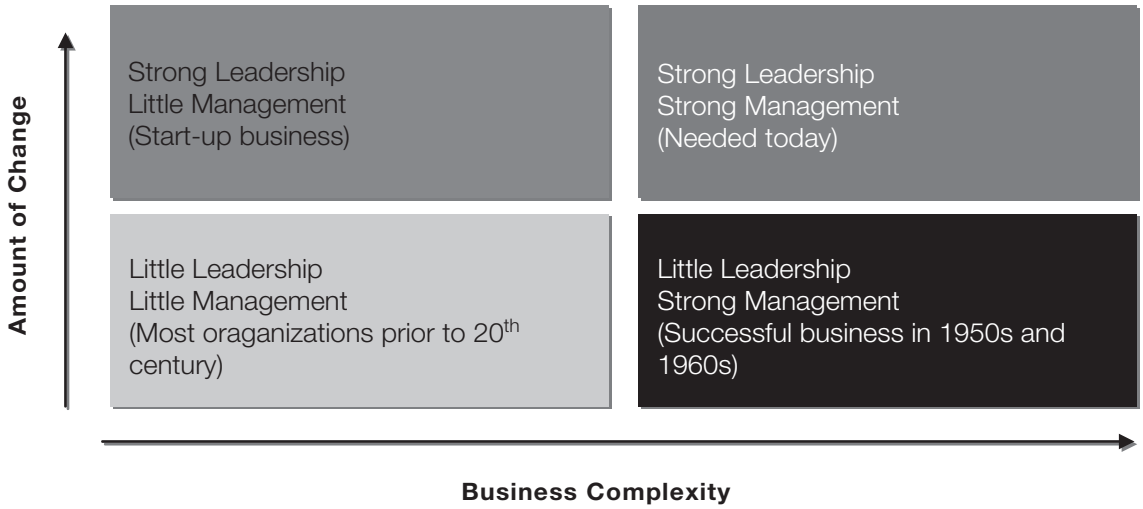


**Illustration 4.3: Leadership and Roles**

| | Start-up | Initial growth | Mid growth | Late growth | Maturation |
|---|---|---|---|---|---|
| **Primary company activities** | • Business concept<br>• Product development<br>• Market analysis<br>• R&D<br>• Company information<br>• Attracting capital | • Market entry – niche<br>• Production<br>• R&D<br>• Infrastructure<br>• Sales and marketing | • Market entry – mainstream<br>• Sales and marketing<br>• R&D | • New market entry<br>• Sales and marketing<br>• R&D | • Reinvention of products or services<br>• Sales and marketing<br>• R&D<br>• Production and process efficiencies |
| **Leadership roles** | • Decision-maker<br>• Doer | • Delegator<br>• Direction setter | • Team builder<br>• Coach<br>• Planner<br>• Communicator | • Change catalyst<br>• Organization builder<br>• Strategic innovator<br>• Culture driver | • Transformation director<br>• Succession planner |
| **Leadership responsibilities** | • Take part in all business activities<br>• Responsible for virtually every major decision | • Articulate and communicate vision and values<br>• Utilize resources efficiently<br>• Execute strategy<br>• Hire talented people | • Hire people to fill functional voids<br>• Ensure management team gets together<br>• Help define roles/ responsibilities<br>• Align team with vision and culture<br>• Develop more leaders | • Recognize need for fundamental change<br>• Find and develop high-level partnerships and relationships<br>• Motivate and inspire; promote values and culture<br>• Develop more leaders | • Facilitate transition to new growth strategy<br>• Help reinvent company<br>• Re-energize and inspire employees<br>• Create the foundation for a successful transition |

### Tool 4.4: An Executive's Diagnostics

*Recognizing leadership requirements, making current leaders more effective, and developing the optimal leadership team are three key steps towards creating the right leadership. The following 20 questions will help you to assess these three areas within your company and to evaluate your current leadership development process.*

| | | Yes | Somewhat | No |
|---|---|---|---|---|
| ***Recognize your requirements*** | | | | |
| 1 | Do you understand that leadership is about vision, direction setting, and establishing relationships whereas management is based on a set of specific responsibilities and tasks? | | | |
| 2 | Are strong leadership and management considered essential to your company's success? | | | |
| 3 | Does your company has a balanced group of leaders and managers? | | | |
| 4 | Do you consider leadership an important factor in your company's growth? | | | |
| 5 | Is leadership considered a company-wide responsibility rather than one reserved only for those employees in senior management positions? | | | |
| ***Make your leaders more effective*** | | | | |
| 6 | Are the duties and responsibilities of your company's leaders evolving as your company moves from one phase of its life-cycle to the other? | | | |
| 7 | Is your company hiring new talent to fill leadership roles? | | | |
| 8 | Does the leadership style of your company reflect the internal and external factors that the company faces? | | | |
| 9 | Is your company experimenting with different leadership styles in order to determine which approaches work best? | | | |
| 10 | Are the culture and efforts of your company directed towards enhancing trust, integrity, honesty, and self-sacrifice? | | | |
| 11 | Do your leaders' actions reinforce your company's vision and strategic plans while inspiring and motivating employees? | | | |

| | | Yes | Somewhat | No |
|---|---|---|---|---|
| ***Develop your leadership team*** | | | | |
| 12 | Is your company currently assessing the need for more leaders throughout your organization? | | | |
| 13 | Does your company have an established process to identify and develop new leaders? | | | |
| 14 | Do you feel that developing new leaders is an important part of your leadership role? | | | |
| 15 | Does your company offer training, development, and incentives to create new leaders? | | | |
| 16 | Does your company select leadership candidates based on talent and an ability to learn? | | | |
| 17 | Does your company search for developmental experiences and assign them to leadership candidates? | | | |
| 18 | Do you allow people to take risks and learn from their mistakes? | | | |
| 19 | Does your company have the human resources and financial and executive support to foster a culture of leadership? | | | |
| 20 | Does your company have a visible and/or well-articulated process in place to generate new leaders at all levels? | | | |

*If more than 75% of your answers (15 of 20) are "Yes", then your company is addressing the challenge of creating effective leadership. If 50% to 75% of your answers are "Yes" or "Somewhat", there is more work to be done in order to create effective leadership. If less than 50% of your answers are either "Yes" or "Somewhat", your company needs to re-evaluate its approach towards creating effective leadership.*

| | | |
|---|---|---|
| ***Re-evaluate →*** | ***→ Needs more work →*** | ***→ Ready*** |
| ***0 - 49% →*** | ***→ 50 - 75% →*** | ***→ 76 - 100%*** |

## 5. Further Readings/References


- Kelly M. Hannum, Jennifer W. Martineau and Claire Reinelt. "The Handbook of Leadership Development Evaluation." 2007.
- Antony Bell. "Great Leadership: What It Is and What It Takes in a Complex World." 2006
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The Hong Kong Institute of Directors

Corporate Governance Toolkit

# Develop Business Objectives and Strategies

Reference and page number in “Guidelines on corporate Governance for SMEs in Hong Kong”

| **Reference number** | **Page** | **Title → subtitle in Guidelines** |
|---|---|---|
| 2.2.2 (b) | 17 | What governance practices do Hong Kong SMEs need? → Category 1 |
| 2.3.2 (d) | 19 | What governance practices do Hong Kong SMEs need? → Category 2 |
| 2.4.3 (b) | 23 | What governance practices do Hong Kong SMEs need? → Category 3 |
| 2.4.4 (e) | 25 | What governance practices do Hong Kong SMEs need? → Category 3 |
| 2.5.26 | 33 | What governance practices do Hong Kong SMEs need? → Category 4 |
| 2.5.39 | 36 | What governance practices do Hong Kong SMEs need? → Category 4 |
| 2.5.42 (e) | 38 | What governance practices do Hong Kong SMEs need? → Category 4 |
| 4.2.1 – 4.2.2 | 48 | Management practice guidelines → Planning |

Management practice cycle (“Guidelines on corporate Governance for SMEs in Hong Kong” page 8)

| **Cycle Number** | **Management practice cycle** |
|---|---|
| 1 | Planning |
| 2 | Key Performance Indicators (KPIs) |
| 3 | Operations/Implementation |
| 4 | Organising |
| 6 | Controlling |

# 1. Overview

A key aspect of managing a company is moving the company towards a defined objective. Most of the disciplines of management, e.g. budgeting, strategic planning, performance management, will become effective only if an appropriate objective has been set.

After defining the business objective, companies must have a clearly articulated and executable strategy in order to achieve the business objective. A business strategy is a perspective, position, plan and pattern that defines the range of business the company is to pursue, the kind of economic and human organization it is or intends to be, and the nature of the economic and non-economic contribution it intends to make to its stakeholders.

# 2. What You Can Do

## 2.1. Define business objectives

Companies sometimes summarize business objectives into mission, vision and values as follow:

- **Mission.** A mission of a company is a statement of the company's purpose or its fundamental reason for existing. The statement spotlights what business a company is presently in and the customer needs it's presently striving to meet. A mission statement should be developed based on the core competencies of the company and motivates employee's behaviour. A mission statement should be short, specific, sharply focused and memorable. Examples of a mission statement are: "To provide one-stop IT solution to companies" or "To let customers to experience authentic Chinese cuisine".

- **Vision.** A vision is a statement relating to what the company wants to achieve. It should provide long-term direction, delineate what kind of enterprise the company is trying to become, and infuse the organization with a sense of purposeful action. A vision statement should be audacious, inspiring, motivating and capitalizes on the company's core competencies. Examples of a vision statement are: "To be the Hong Kong best restaurant' or "To be the first choice provider in the market".

- **Value.** Value relates to the core belief of the company and its deeply held convictions, priorities, and underlying assumptions that influence the company members' attitudes and behaviours. A value statement should be specific and compose of a few phrases, rather than just one sentence. Examples of value statements are "We are committed to the highest standards of ethical conduct in all that we do. We believe that honesty and integrity engender trust, which is the cornerstone of our business." or "We understand the importance of our missions and the trust our customers place in us. With this in mind, we strive to excel in every aspect of our business and approach every challenge with a determination to succeed."

When defining the mission, vision and value of the company, it is crucial to obtain the support of senior management and employees. These statements should be clearly communicated to all members of the company and aligned with daily operating activities. These statements should be reinforced by incorporating them into individual employee's goals and performance targets. These statements should be revisit on a periodic basis to ensure that it adapts to the changing business environment.

## 2.2. Assess the environment

Before developing the strategy, it is important for the company to understand the internal and external environment in which it is operating.

- **Analyze the external environment.** External environment should be analyzed based on four drivers:

  - **Markets:** market segments, characteristics of the segments, growth potential of the segments and the market's perception of the company's performance.

  - **Competition:** the current and future competitors, how they are positioned, their strengths and weaknesses, and the barriers to entry and exit.

  - **Technology:** the costs, adoption rates, enabling technologies and trends.

  - **Regulation:** the regulatory policy, legislation, and standards imposed on the industry.

  A brain-storming session with senior management can produce valuable insights into an industry's structure and help companies understand what makes one company more profitable than others. Information can also be gathered through market research analysis, focus groups, etc.

  After analyzing the above four drivers, companies should have a solid understanding of the key drivers affecting their industries. They will have identified opportunities, such as unserved target segments, and detected market threats. Companies operating in environments of significant uncertainty will have developed several future industry scenarios. These scenarios will later be used to assess the risks and rewards of potential strategic plans.

- **Assess the company's capabilities.** Having assessed the external environment, a review of the company's internal capabilities or competencies is needed to identify relative strengths and weaknesses. These insights will help determine whether the company is capable of capitalizing on any opportunities or neutralizing any threats they may have identified. A company's competencies are its physical or intangible resources and capabilities. The challenge is to think of the company in terms of its invisible assets and core competencies which are embedded in the company's practice or knowledge, such as reputation and technical know-how. A complete picture of the functioning of a company can be derived by analyzing the following aspects:

  - **Resources:** inputs into the overall value chain that are assessed as being either tangible (e.g. plants, equipment) or intangible (e.g. patents, intellectual capital).

  - **Infrastructure:** the value chain; a set of activities and processes that allows a company to transform its inputs into outputs.

- **Products:** these embody the company's existing value proposition to the market and can be analyzed according to two factors: external significance (e.g. set of product/service attributes, unit price); and internal significance (e.g. design complexity, unit costs and profitability).

- **Customers:** the target market segments that currently purchase the products/services.

- **Develop key insights.** Potential strategies are formulated from the insights gained during the external and internal environmental analysis. Identifying and defining key insights with a senior management team provides a shared understanding of (i) the company's strengths, weaknesses, opportunities, and threats; (ii) sources of competitive advantage; (iii) its ability to stretch industry boundaries and to challenge the status quo. One way to facilitate the development of potential strategies is to categorize each threat and opportunity into a four quadrants matrix. For illustration, please refer to Illustration 4.1. After identifying whether the anticipated industry change presents an opportunity or a threat, companies must assess whether the critical success factor required to address the change is an area of strength or weakness for them. If it is strength, the strategy required to address the industry change will likely to be a leverage strategy (i.e. it will capitalize on and enhance the company's core competency in order to create competitive advantage). If it is a weakness, the strategy will likely to be a conversion strategy (i.e. it will require a core competency to be incubated, evolved or acquired before it can be leveraged).

### 2.3. Develop a strategy

Every strategy option should enhance and leverage a company's core competencies to ensure competitive advantage. Once a strategic option has been selected, strategic initiatives may be developed to fill capability gaps and ensure that all activities fit within the strategy. Once these initiatives have been developed, they can be evaluated in preparation for establishing a strategic direction.

- **Develop strategic options.** For every opportunity or threat identified, at least one strategic option may be developed. Strategic options define what a company may choose to do to compete effectively. They must be grounded in the company's value and restricted by its corporate constraints. Each strategic option should identify the opportunity or threat it intends to address, the critical success factors needed to address it, and how the company intends to develop its capabilities if it does not have a core competency in that area.

  Developing strategic options is a creative process that draws extensively on key insights from both the external and internal environmental assessments. Companies should aim for a strategic planning process that generate a variety of ideas. The process should include senior management representatives from all functional areas to ensure that many different perspectives are reflected. A wide variety of strategic options are available to companies. For example, strategic options can focus on delivering a new value proposition to an entirely new target segment or acquiring competitors that are currently serving the target segment.

- **Evaluate the strategic options.** The evaluation criteria for strategic options can be grouped into two broad dimensions of analysis: risk and reward. Typically, the more aggressive the strategic option, the higher the potential rewards and the higher the risks.

  Both financial and strategic implications should be considered as potential rewards of the strategic option being assessed. To address the financial implications, a cash flow forecast model should be created that will capture the expected profits. Strategic implications provide the opportunity to consider rewards that are vital but are not readily quantifiable in the form of future profits.

  When assessing the potential risk of a strategic option, both market and execution risks should be considered. Market risks may include an emerging target market segment that does not materialize or appreciate the value proposition or a competitor response that is more aggressive than anticipated. Execution risks concern the implementation of largely controllable internal initiatives, upon which the rewards of the strategic option are dependent. For each strategic option, all the internal capabilities required to execute the option must be understood and mapped to the current set of capabilities of the company. Execution risks are determined by the size of the gap between the two and the importance of the capability.

  If operating in an uncertain environment, each of the strategic options should be evaluated based on each of the scenarios developed during the external analysis. This scenario analysis will help test the merit of each strategic option.

- **Establish the strategic direction.** Once the strategic option has been selected, it must be expanded into specific initiatives that will determine how the strategic direction is to be implemented. Communicating the detailed value proposition that the company intends to offer under the chosen strategic direction is the first step in ensuring that the company is aligned with the new strategy. The value proposition is the tangible manifestation of the company's vision and strategy.

  The second step to aligning the company and its strategy is to ensure that the company's capabilities are focused on delivery of the value proposition. Each activity or capability will fit if it has at least one of the following characteristics: (1) the activity must be consistent with the strategy; (2) it should reinforce the performance of other activities; (3) it should optimize the chain of activities.

## 2.4. Implement the Strategy

Once the strategy is chosen, strategic initiatives must be communicated to all individuals in the company and used to formulate actual business plans. To ensure the effective communication of a strategy it is important to establish plans and targets and to maintain flexibility.

- **Communicate the strategy.** It is impossible for an individual or line of communication to align an entire company. Instead, companies should use several interrelated mechanisms to translate the strategy into objectives and measures that will influence individual and team priorities. The following are three suggested mechanisms:

    - **Communication and education programs:** Establish a consistent and continuing program that educates the company on the components of the strategy and reinforces this education with feedback on actual performance.

    - **Goal-setting programs:** Once a base level of understanding exists, individuals and teams throughout the company must translate the high-level strategic objectives into personal and team goals.

    - **Reward system linkage:** Alignment of the company towards the strategy must ultimately be reflected in incentive and reward systems.

- **Establish plans and targets; measure and reward performance.** Armed with a perspective of the overall strategy, middle management must now translate strategic initiatives into smaller, digestible action plans and goals. It can be advantageous to use broad participation in establishing action plans. It is also important to create goals at the team and individual levels.

  The next step in implementing the strategy is to develop a plan that specifically defines how financial, human, and other resources must be spent over time. At this point it is important to implement an integrated strategy and budgeting process that will close the gap between the current performance and the targets to be achieved.

  By continually testing underlying strategies and how they are being implemented, companies can ensure that they are moving toward the established strategy. A necessary condition for testing is the formulation of specific short-term targets. These short-term targets, or milestones, are an expression of a company's expectations concerning the speed and impact of the current initiatives.

- **Maintain strategic flexibility.** A successful growth strategy will help a company achieve its growth vision. By continually creating, exploiting, and transforming its value proposition, a company can realize its full growth potential. Strategies for today's companies cannot be linear or stable, and some key aspects should be kept in mind:

  - Strategies are incremental and emerge over time;
  - Intended strategies can be superseded;
  - Strategy formulation and implementation are intertwined; and
  - Strategic ideas can arise throughout the organization.

  Companies need to devise new strategies to capitalize on new opportunities. An effective strategic learning process with the following components needs to be developed to maintain strategic flexibility:

  - A strategic framework that allows each participant to see how his or her activities contribute to the achievement of the overall strategy;
  - A feedback process that collects performance data about the strategy; and
  - A team problem-solving process that analyzes and learns from the performance data and then adapts the strategy to emerging conditions.

## 3. Benefits/Limitations

**3.1. Benefits.** Without establishing business objectives and strategies, the company will not have a well defined direction. It is critical for all companies to know what they are doing, how they are doing it, and why they are doing it. Having well defined business objectives and strategies provide greater flexibility and speed in responding to opportunities and market changes. Additionally, they also help solidify the corporate values and strengthen employee morale.

**3.2. Limitations.** Developing business objectives and implementing business strategies can be complicated, costly, and time consuming. For SMEs, setting business objectives and strategies is relatively simple. But for large enterprises, such process can be very complicated and it may involve the employment of technical or professional expertises. In addition, the achievement of business objectives and execution of business strategies rely on the aggregate effort of employees at all levels, which is easier said than done. Some departments and individuals may disagree on those common objectives and be unwilling to achieve them.

## 4. Tools, Templates and Illustration

**Illustration 4.1: Classification of Opportunities and Threats**

| | **Opportunity** | **Threats** |
|---|---|---|
| **Critical success factors are company STRENGTHS (as shown in parentheses)** | Leverage strategies | |
| | Exploit opportunities | Neutralize threat |
| | • Large market segment identified as underserved (strong sales and marketing capabilities)<br>• Buying power over suppliers available to industry consolidators (access to capital) | • New production introduction by competitor (rapid product development)<br>• Growth in substitute products (innovative culture designed to differentiate products) |
| **Critical success factors are company WEAKNESSES (shown in parentheses)** | Conversion strategies | |
| | Convert weakness to strength and exploit opportunity or forgo opportunity | Convert weakness to strength and neatralize threat or consider with drawing from market |
| | • Technological advance could improve product performance (limited expertise in technology)<br>• Customers developing need for extended range of related services (limited ability to offer related services) | • Increase in raw material prices (reliance on limited set of suppliers)<br>• Changes in government regulation to lower barriers to entry (limited lobbying expertise) |

### Tools 4.2: An Executive's Diagnostic

*Assessing your company's environment and developing and implementing a detailed strategic plan, are key steps towards ensuring that your company is on the path to sustainable growth. The following 20 questions will help you evaluate your strategic planning process.*

| | | Yes | Somewhat | No |
|---|---|---|---|---|
| ***Assess the environment*** | | | | |
| 1 | Have you assessed how regulation, markets, competition, and technology will create new opportunities, and new threats, in your industry? | | | |
| 2 | Have you established a view of the future of your industry, or, if you operate in a particularly uncertain environment, have you considered several distinct scenarios for the future of your industry? | | | |
| 3 | Does your company follow a formal process for identifying and segmenting target markets and fully understanding the needs of customers in those segments? | | | |
| 4 | Have you determined the critical success factors that enable companies to successfully compete in the current and future states of your industry? | | | |
| 5 | Have you assessed the competitive strengths and weaknesses of your company's resources, infrastructure, products, and customers? | | | |
| 6 | Does your company have a process to develop strategic options by comparing your company's strengths and weaknesses with the critical success factors required to successfully address industry opportunities and threats? | | | |
| 7 | Does your current strategic planning process include the active participation of senior representatives from all of your company's functional areas? | | | |
| 8 | Does your company support strategic decisions with data and facts as opposed to intuitions? | | | |
| ***Develop a strategy*** | | | | |
| 9 | Does your company formally consider how to shape or redefine the industry in which it competes? | | | |
| 10 | Has your company analyzed its required core competencies and identified ways to develop and leverage them in existing and new markets? | | | |

| | | Yes | Somewhat | No |
|---|---|---|---|---|
| 11 | Do you assess the potential rewards as well as the market-related and execution-related risks for potential strategic options when selecting a single strategic direction? | | | |
| 12 | Can you convincingly articulate why customers should buy from you instead of from your competitors, both today and five years from now? | | | |
| 13 | Does your company have a formal process to ensure that all its activities are aligned with strategic direction? | | | |
| ***Implement the strategy*** | | | | |
| 14 | Have you established a process to easily translate strategy into actionable next steps? | | | |
| 15 | Has your current strategy been effectively communicated to employees in every level of the company? | | | |
| 16 | Is your current strategy sufficiently specific as to provide the necessary guidance to help every person in the company make effective decisions? | | | |
| 17 | Is middle management actively involved in translating strategic initiatives into smaller, digestible action plans and goals? | | | |
| 18 | Is your budgeting process linked to your strategic planning process such that human, financial, and other resources are directed appropriately? | | | |
| 19 | Is your current strategic planning process sufficiently flexible to accommodate changes in your company's dynamic environment? | | | |
| 20 | Does your company have a feedback process that evaluates the success of implementing the strategy and enables you to learn from the experience and adapt the strategy as necessary? | | | |

***Scoring key:***

*If more than 75% of your answers (16 of 20) are "Yes," then your company is addressing the challenge of developing strategic plans. If 50 to 75% of your answers (10 to 15) are "Yes" or "Somewhat," there is more work to be done in order to develop strategic plans. If less than 50% of your answers are either "Yes" or "Somewhat," your company needs to re-evaluate its approach towards developing strategic plans.*

| | | |
|---|---|---|
| ***Re-evaluate →<br>0 - 50% →*** | ***→ Needs more work →<br>→ 50 - 75% →*** | ***→ Ready<br>→ 75 - 100%*** |

## 5. Further Readings/References


- "Strategy is key to sustainable growth: How a robust strategic plan can set companies on a course to growth." Deloitte Publications. http://www.deloitte.com/dtt/article/0,1002,sid%253D94592%2526cid%253D158734,00.html

- "The Business Plan: Writing a Successful Business Plan." Deloitte Publications. http://www.deloitte.com/dtt/article/0,1002,sid%253D2886%2526cid%253D57759,00.html

# The Hong Kong Institute of Directors

# Corporate Governance Toolkit

# Enhance Decision Making

Reference and page number in “Guidelines on corporate Governance for SMEs in Hong Kong”

| **Reference number** | **Page** | **Title → subtitle in Guidelines** |
|---|---|---|
| 2.1.10 (e) | 16 | What governance practices do Hong Kong SMEs need? → The need for good governance |
| 2.2.2 (b) | 17 | What governance practices do Hong Kong SMEs need? → Category 1 |
| 2.3.3 (b) | 21 | What governance practices do Hong Kong SMEs need? → Category 2 |
| 4.4.1 | 51 | Management practice guidelines → Operations/implementation |

Management practice cycle (“Guidelines on corporate Governance for SMEs in Hong Kong” page 8)

| **Cycle Number** | **Management practice cycle** |
|---|---|
| 1 | Planning |
| 3 | Operations/Implementation |

# 1. Overview

Effective and efficient decision making is critical to the success of every company. If companies fail to make appropriate decisions, then sales, market share, expenses, customer and employee satisfaction, profits, and shareholder dividends can all be seriously affected. For SMEs, although the decision making process is relatively centralized and simple as compared to large conglomerates, the lack of a systematic decision making process may lead to overlooking of potential problems and failure in identifying better alternatives causing unnecessary financial loss or adverse impact to company's growth.

In order to enhance the quality of decision making, the following two easy-to-use and simple decision making tools are available:

1) SWOT Analysis (Strengths, Weaknesses, Opportunities, and Threats)

2) Cost-Benefit Analysis

# 2. What You Can Do

## 2.1. Develop a SWOT analysis

SWOT Analysis provides a framework for identifying critical issues of a strategic nature. The analysis is limited to the specific strengths, weaknesses, opportunities and threats that characterize a situation. Strengths and weaknesses tend to be internal considerations, and opportunities and threats tend to be external considerations. This tool enables management to assess the pros and cons of various business decisions faced by the company, such as:

- Investment in new capital;
- Changes in a market strategy;
- Initiation of cost reduction activities; and
- Mergers and acquisitions.

SWOT analysis is a tool used to collect relevant information to assess the following:

- **Strengths** – These are strong attributes or inherent assets. They may include such attributes as: a collective company competency, an asset, or capability for which the company has achieved a high level of proficiency, or strong market/customer recognition for quality and value.
- **Weaknesses** – These are the opposite of strengths; lacking skill or proficiency. For example, they may include a collective company competency, asset, or capability which is competitively inferior and, consequently, provides a vulnerability for competitors to exploit.

- **Opportunities** – Represent a good chance for advancement or progress. For example, consider a trend or an event that could lead to a positive change in position if addressed by a strategic response (i.e. R&D department just developed a new drug that greatly reduces mortality rates from a certain form of cancer). All that is required is a plan for regulatory approval and a market plan.

- **Threats** – These are an indication of some impending damage. For example, a trend or event that could lead to a negative change in position if not addressed by a strategic response.

The following five steps comprise of the SWOT analysis:

- **Define your objectives.** The key to an effective SWOT analysis begins with a clear understanding of the needs and the issues that drive the analysis. That is, what are you attempting to accomplish with the SWOT analysis? The purpose of conducting a SWOT analysis can be wide or narrow, general or specific, such as determining the business strategy or developing a marketing plan for a specific product.

- **Develop your information needs.** After defining the objectives, the company should create a data collection guideline to ensure that necessary information is collected for conducting the SWOT analysis. The following data highlights some of the key elements of the external and internal environments that should be obtained for a SWOT analysis:

    - External
        - Market dynamics (e.g. trends on demand, prices and competition);
        - Market size;
        - Market growth;
        - Competitor profiles; and
        - Key trends affecting the market (e.g. political/regulatory, economic, social and technology)

    - Internal
        - Strategy/business plans;
        - Culture;
        - Product/service capabilities;
        - Infrastructure (e.g. process and technology);
        - Management structure;
        - Customer analysis by profiles/segments/profitability; and
        - Workforce capability.

- **Collect internal and external data.** Data gathering is a critical stage for the subsequent analysis to be effective. The company should identify internal and external sources of information and collect the data via interviews and focus group with internal staff, internal documents (such as business plans and marketing reports), external documents (such as industry trend analysis and government reports), etc.

- **Develop the SWOT list.** After obtaining and analyzing the required information, the company should compile the SWOT list by identifying the strengths, weaknesses, opportunities and threats. This process can be done by conducting brainstorming sessions/meetings with internal management and staff. The participants should be selected from different functions (such as marketing, finance, human resources, etc.) to ensure all the necessary and related business perspectives are considered when developing the SWOT list.

- **Evaluate Options.** After developing the SWOT list, management should identify the possible opportunities or responses in relation to the SWOT elements and assess the implications of each option to the company. Management should also develop criteria with which they will evaluate and rank each option and select the option that best meets the needs of the business issue. The possible options will usually fall into two categories:

    - Enhancement of existing operations or processes, such as installation of a new management information system or reengineering of an existing process to improve efficiency;

    - Development of a new initiative, such as mergers and acquisitions, new products and services or selling to new markets.

For the example and template of SWOT analysis, please refer to Illustration 4.1.

### 2.2. Develop a Cost-Benefit analysis

Cost-benefit analysis is a monetary assessment of costs and benefits of a project or investment. It involves the identification and calculation of both tangible and intangible costs and benefits associated with each option. The ultimate purpose of this analysis is to identify the option that provides the maximum benefits with minimum costs. Besides simply dividing the benefits by costs, management should also consider taking the time value factor into account by using the net present value methods.

The cost-benefit analysis should be conducted with the following steps:

- **Define the overall objectives.** The first step of doing a cost-benefit analysis is to define the objective to be achieved in order to address the issue faced by the company. Defining what is required to be achieved is critical to the success of the decision making process.

- **Prepare a detailed list of anticipated benefits and correspondent costs.** The list of anticipated benefits and related cost should include all the tangible and intangible benefits and costs, such as cost of construction, depreciation, interest charges, environmental cost, etc.

- **Assign monetary value to anticipate benefits and costs to determine the cash inflow and cash outflow.** The company should translate the anticipated benefits and costs on the list into estimated monetary values in order to arrive at an approximate value of net benefit of the project. The anticipated benefit should be considered as cash inflow, whereas the associated costs should be considered as cash outflow. The estimation should be made based on past experiences, internal forecast reports, researches, etc. The assumptions made and the calculation basis should be discussed with the related personnel and process owners, and they should be consistently applied for different alternative projects/investments.

- **Calculate the net cash flow and net present value.** The stream of net cash flow is predicted for each year/period of the project. The net cash flow of each year/period will be the value of the cash inflow minus the cash outflow. This stream will be expressed as a positive or negative net cash flow depending on whether benefits exceed costs. The present value of each year's net cash flow should be calculated using a discount rate that reflects the cost of funds. The net present value of the project/investment should be calculated by summing up all the discounted cash flow of each year.

- **Analyze the results.** If the net present value is positive, the project/investment is considered to be acceptable on quantifiable grounds because it will add value to the company. If the net present value is negative, the project should not be accepted on quantifiable grounds because the project will reduce the company's value. If the net present value is zero, the company's value will not change by accepting the project.

- **Make the decision.** After calculating the net present value for all alternative options, the company should choose the one with the highest net present value since the option with the highest net present value will provide the greatest financial benefits to the company. However, besides making a decision based on quantitative analysis, the company should also consider qualitative benefits or drawbacks associated with the project, such as reputation, environmental issues, staff morale, etc.

For the example and template of cost and benefit analysis, please refer to Illustration 4.3.

## 3. Benefits/Limitations

**3.1. Benefits.** Using a SWOT analysis to facilitate the decision making process can provide management an outline of the major issues affecting the industry and the business, and identifies the basis for developing strategies. It is an effective tool for gaining valuable insights for the company with respect to operations, people, culture and direction. The external examination of opportunities and threats leverages many other performance modules and tools.

Cost-benefit analysis can be used to ensure that value for money is obtained from a project which requires the investment of funds. It also goes beyond this by providing a basis for assessing the merits of different projects in terms of the benefits they produce and the costs that will be incurred.

**3.2. Limitations.** A SWOT analysis may not necessarily identify all potential weaknesses and threats subject to constant update and adjustments according to internal and external environmental changes. Although it is useful at analyzing entity-level or large scale issues, it is a time-consuming process for smaller or less sophisticated issues. It is therefore best used when a team of people is participating and when the SWOT structure is likely to help categorize people's comments usefully for later action to be taken.

Cost-benefit analysis is a basic tool where costs and benefits are easily identified and the time period involved is relatively short (e.g. 3-5 years). In such case, it may not be useful for large, multifaceted, long-term projects (e.g. > 10 years). This tool is based on the chosen discount rate to obtain net present value. The real discount rate will vary frequently and not reflect accurately the true time value of the project and therefore leave residual error in the result. In addition, this tool mainly focuses on the quantitative assessment and ignores the qualitative aspect of the project. Therefore, the company should also evaluate the possible qualitative effect when making the final decision.

## 4. Tools, Templates and Illustrations

### Illustration 4.1: SWOT Analysis

| Strengths | Weaknesses |
|---|---|
| 1. Strong market share in key markets<br>2 Strong reputation<br>3 Brand identity<br>4 Technical know-how<br>5 Strong after-sales service | 1. Lack of entrepreneurial spirit & general business awareness<br>2. Poor communication with suppliers<br>3. Poor collection records<br>4. Lack of product diversification |
| **Opportunities** | **Threats** |
| 1. Change of government regulations<br>2. Large unexploited market<br>3. Increase in customer's product awareness | 1. Aggressive marketing by competitors<br>2. Lack of technical expertise in the market<br>3. Increase of product substitutes<br>4. Increase of interest rate. i.e. higher cost of capital |

**SWOT Analysis Templates:**

Please download the template at the following website:
http://www.hkiod.com/eng/publication_highlight.asp

**Definitions & Examples:**

1. Strengths: Is a strong attribute or inherent asset. It might include such attributes as: a collective company competency, an asset, or capability for which the company has achieved a high level of proficiency, or strong market/customer recognition for quality and value.

   Examples: high market dominance
   core competencies
   economies of scale
   low-cost position
   strong leadership and management skills
   sufficient financial resources
   differentiated products
   board distribution network

2. **Weaknesses:** Is the opposite of strength; lacking skill or proficiency. It may include: a collective company competency, asset, or capability which is competitively inferior and, consequently, provides a vulnerability for competitors to exploit.

   Examples: low market share
   few core competencies
   high cost base
   undifferentiated products
   lack of distribution channels
   employee skills gap
   out-of-date plant
   limited financial resources

3. **Opportunities:** Represents a good chance for advancement or progress. Consider a trend or an event that could lead to a positive change in position if addressed by a strategic response. All that is required is a plan for regulatory approval and a market plan.

   Examples: technology innovation
   new customer demand
   diversification opportunity
   market growth
   research innovation
   economic upswing
   acquisition and partnerships
   trade liberalization

4. **Threats:** Is an indication of something damaging impending. That is, a trend or event that could lead to a negative change in position if not addressed by a strategic response.

   Examples: new market entrants
   competitive price pressure
   changing customer needs
   consolidation among buyers
   threats from substitutes
   capacity growth outstrips demand growth
   cyclical downturn
   requlation and legislation pressure

### Illustration 4.3: Cost-benefit Analysis

**Net Present Value Analysis ('000)**

| Year | 0 | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|---|
| **Cash Inflow** | | | | | | |
| **Revenue:** | | 1,750 | 1,838 | 1,929 | | |
| **Depreciation Allowance Saved:** | | 500 | 500 | 500 | 500 | 500 |
| **Defect Saved:** | | 100 | 100 | 100 | | |
| **Maintenance Saved:** | | 100 | 100 | 100 | | |
| **Total Cash Inflow** | | 2,450 | 2,538 | 2,629 | 500 | 500 |
| **Cash Outflow** | | | | | | |
| **Initial Investment:** | (2,000) | | | | | |
| **Material Cost:** | | (578) | (606) | (637) | | |
| **Labour Cost:** | | (600) | (600) | (600) | | |
| **Total Cash Outflow** | (2,000) | (1,178) | (1,206) | (1,237) | – | – |
| **Total Net Cash Flow** | (2,000) | 1,273 | 1,331 | 1,393 | 500 | 500 |
| **After tax Cash Flow** | (2,000) | 1,069 | 1,118 | 1,170 | 420 | 420 |
| **Discounted Rate Factor (18.72%)** | 1.00 | 0.84 | 0.71 | 0.60 | 0.50 | 0.42 |
| **Present Value** | (2,000) | 898 | 789 | 697 | 210 | 176 |
| **Total Net Present Value:** | 770 | | | | | |

Please download the template at the following website:
http://www.hkiod.com/eng/publication_highlight.asp

## 5. Further Readings/References


- Ray Myers, Jr. “Business Tools and Metrics: Reference for Students and Professionals.” Pocket Crib © 2006

- Deborah J. Mayhew. “The Usability Engineering Lifecycle: A Practitioner’s Handbook for User Interface Design.” Morgan Kaufmann Publishers© 1999

# The Hong Kong Institute of Directors

# Corporate Governance Toolkit

# Enhance Organizational Structure

Reference and page number in “Guidelines on corporate Governance for SMEs in Hong Kong”

| **Reference number** | **Page** | **Title → subtitle in Guidelines** |
|---|---|---|
| 1.3.3 | 10 | The concept of corporate governance and its importance → Small and medium enterprises in Hong Kong |
| 4.5.1 | 51 | Management practice guidelines → Organising |

Management practice cycle (“Guidelines on corporate Governance for SMEs in Hong Kong” page 8)

| **Cycle Number** | **Management practice cycle** |
|---|---|
| 4 | Organising |

## 1. Overview

An organisational structure defines the network of relationships and interactions within a company and provides a setting for planning, implementing, and monitoring the company's operations.

Developing an optimal organisational structure is one of the most important determinants of long-term success. A well defined organisational structure with clear reporting lines will enhance accountability, communication of information and implementation of systems and controls.

For SMEs, an overcomplicated organisational structure may create duplication of efforts and bureaucracy leading to inefficiency of operations. To evaluate whether a company's organisation structure is suitable for growth, the company should consider the company's age and size, its stages of evolution and resolution and the growth rate of its industry.

## 2. What You Can Do

**2.1. Determine the most appropriate organizational structure.** When determining the organisational structure that best fits the company, it needs to be aware of its position in the growth cycle, size of the company, the industry in which it operates, management leadership style, the competence of its employees, and its strategic plans. In general, there are three types of organisational structure for management to consider:

- **Functional structure.** The functional structure groups the company's activities by specialized functions, such as marketing, product development. A functional structure is well suited to companies which have a single or dominant core product because each subunit becomes extremely adept at performing its particular portion of the process. The functional structure can enhance productivity gained from specialization and achieve better control and supervision. However, this type of organisational structure lacks flexibility and hinders decision making for the company as a whole. (For the example of a functional structure, please refer to Illustration 5.1)

- **Divisional structure.** Divisional structure is formed when the company is split up into a number of self-managed units, each of which operates as a profit centre. Each product division contains the functions necessary to service the specific goods or services it produces. It is suitable for company with diversified product/service lines. This type of organisational structure can improve teamwork and decision making with clear connection between performance and rewards and achieve better product and customer service quality. But on the other hand, this may lead to poor communication and conflict between divisions increasing the operating and managing costs. (For the example of a divisional structure, please refer to Illustration 5.2)

- **Matrix structure.** A matrix structure overlays two organisational forms in order to leverage the benefits of both. When a company has this structure, it is often referred as being a cross-functional company. It is characterized by utilizing talent from different departments to carry out specific functions or participate in special projects. Under this structure, employees may have dual reporting lines (e.g. reporting to both functional leader and project leader). The advantage of this type of organisational structure is that it facilitates innovation and rapid product development and enhances communication and cooperation between team members. However, this structure may increase role conflict and undermine accountability. In such case, roles and responsibilities of each position should be clearly defined and company should invest sufficient resources in cross-functional training. (For the example of a matrix structure, please refer to Illustration 5.3)

Whichever structure a company adapts, it is critical that the structure:

- Is aligned to the company's goals/objectives and strategies;
- Identifies duties and responsibilities;
- Defines accountability;
- Creates organisational linkages and coordinating mechanisms;
- Is supported by a sound human resources policy;
- Has the support of the company as a whole;
- Is sustainable in the medium and/or long-term; and
- Has leadership styles that are consistent with the culture of the company.

**2.2 Initiate the reorganisation.** If the company determines that it could improve its operations by modifying its structure, it should initiate a reorganisation process. Reorganisation involves redefining roles and responsibilities and levels of authority, which will create significant impact to all levels of employees in the company. Most reorganisation efforts fail because management and employees do not understand why change is necessary. The company firstly needs to create buy-in at top management level and then initiate a systematic communication plan to influence the perceptions at all levels. It is critical for the company to clearly communicate the reasons for change and identify, procure and mobilize the necessary resources to support reorganisation.

**2.3 Evaluate the organizational structure.** Companies should evaluate their organizational structure on a regular basis (such as annually) to determine whether their current structure is commensurate with their business objectives and operating environment. There are several ways in which a company can evaluate its structure efficiency and effectiveness. Some of them are detailed below:

- **Span of Control.** This is the calculation of how many employees a manager supervises, excluding secretaries or administrative support personnel. Typically, this is expressed as 1:6, which would indicate a manager who supervises six other employees. There are no maximums or minimums beyond the practical limits of how many employees can report to a single manager. This is dictated by the expertise of the employees, the leadership style of the manager, and the industry in which the company operates among other factors.

- **Cost to manage.** This represents the manager's salary cost spread across all subordinate salary costs. The cost to manage measure does not reflect a manager's span of control but, rather, the salary of a manager in proportion to those employees he/she supervises. For example, a manager who supervises four employees with a salary of HK$ 25,000 would have the same salary to a manager who supervises ten employees with a salary of HK$ 10,000.

- **Layers of management.** This represents the number of management layers in the organization from the first-level supervisor to the owner/CEO. This analysis "counts" the number of managers that in turn report to other managers. It is useful in making relative comparisons of the management levels between companies of similar size and structure. If a company has significantly more layers than other similar companies, it may be a signal of high levels of bureaucracy.

- **Worker-to-manager ratio.** This summarizes the ratio of workers to managers. It is very similar to span of control, but it may diagnose structural anomalies such as very efficient and effective first-line supervision, but very inefficient and ineffective middle management supervision.

For a preliminary diagnostic of your company's organization structure, please refer to Tool 5.4 for detail.

## 3. Benefits/Limitations

**3.1. Benefits.** Enhancing the organisational structure allows the company to perform its operations more effectively and efficiently. In this regard, it helps the company to avoid duplication of effort and fully utilize the talent of each employee, increasing productivity. Specifying the reporting lines and authority will promote accountability, which facilitates a better corporate governance culture.

**3.2. Limitations.** Conducting reorganisation without a well planned change management process may create serious adverse impact to the company, such as disruption to daily operations, politics, decrease in motivation, increase in operating costs, loss of talent, etc. The change management process is a long-term procedure which requires the buy-in from management and support from all levels of staff.

## 4. Considerations for Business in Mainland China

When designing and developing the organization structure for business in Mainland China, management should pay attention in designing the reporting lines of different departments/functions. Many Hong Kong companies will have manufacturing plant or branches in the Mainland China. In such case, dual reporting lines for departments/functions in the Mainland China's plant/branches may exist. Those departments/functions may report both to the senior management of Mainland China's plant/branches and also to the department/function management located in Hong Kong corporate office. In such case, conflicts may arise between the Mainland China management and Hong Kong management. Therefore, management should pay special attention to the allocation of authority between the two groups of management.

## 5. Tools, Templates and Illustrations

**Illustration 5.1: Functional Structure**

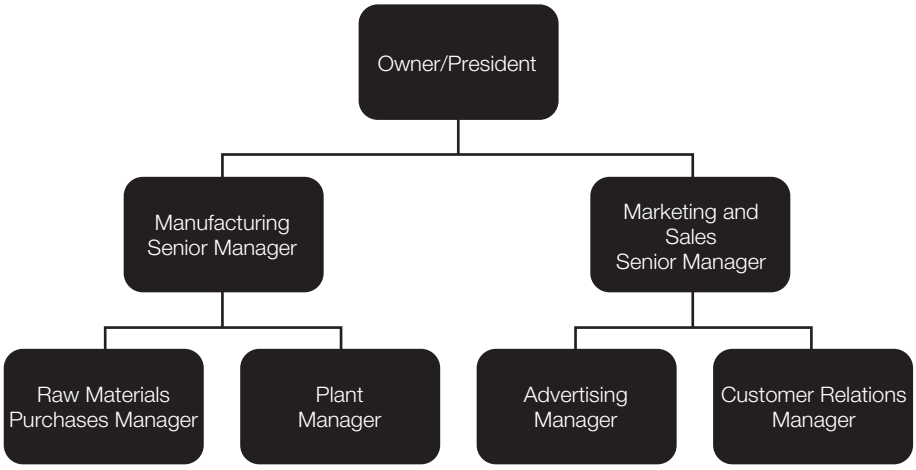


**Illustration 5.2: Divisional Structure**

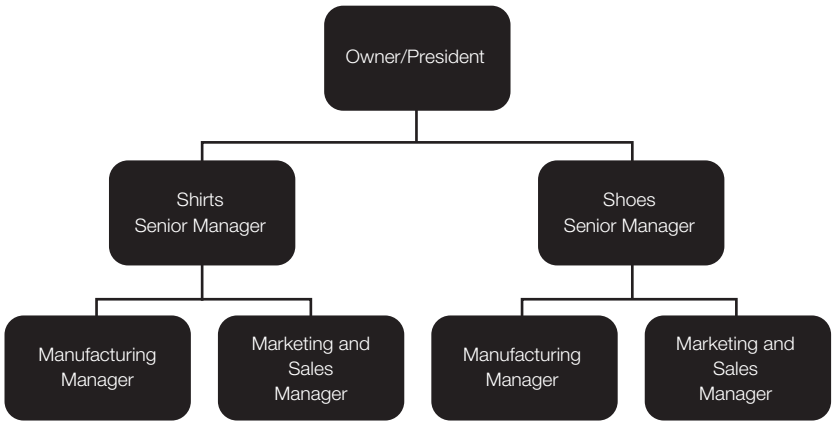
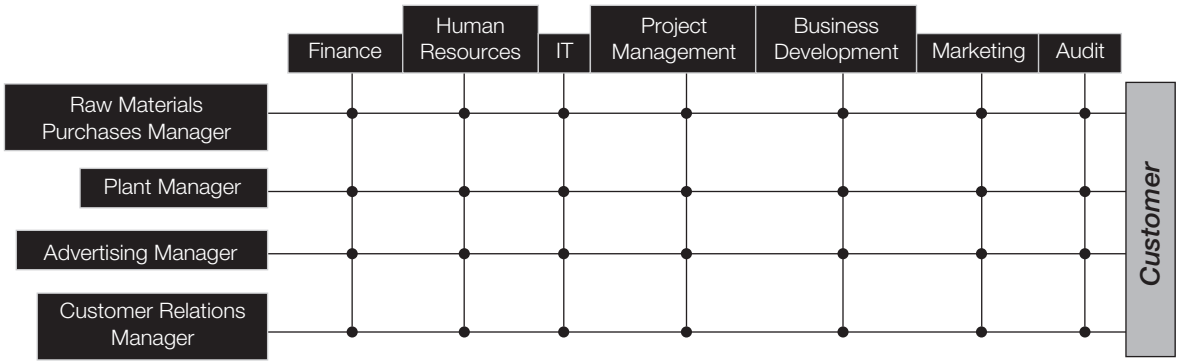



**Illustration 5.3: Matrix Structure**




**Tools 5.4: An Executive Diagnostic over Organization Structure**

*Identifying the right organisational structure, being mindful of the key success factors, and initiating a reorganisation are key steps in designing an efficient organisation. The following 15 questions will help you evaluate the effectiveness of your plan and identify potential areas of improvement.*

| | | Yes | Somewhat | No |
|---|---|---|---|---|
| 1 | Do you consciously plan your organisational structure? | | | |
| 2 | Do you have a set of objectives in mind when you design your organisational structure? | | | |
| 3 | Do you evaluate your organisational structure on its ability to nourish entrepreneurialism, reduce bureaucracy, and maintain control? | | | |
| 4 | Have you identified activities in your company's operations that require participation from different departments? | | | |
| 5 | For the areas that require participation from a variety of departments, are there sufficient performance measures in place that allow you to measure the performance of each department? | | | |

| | | Yes | Somewhat | No |
|---|---|---|---|---|
| 6 | Have you included measures and mechanisms to promote and encourage teamwork across departments? | | | |
| 7 | Have you identified the departments in your organisation whose results are, by nature, more difficult to measure? | | | |
| 8 | For these departments, have you implemented some other measures that allow you to communicate the need for accountability? | | | |
| 9 | Do you review your management layers periodically to identify and evaluate the value they add to the organisation? | | | |
| 10 | Do you consciously reorganize the company to reflect the changing priorities of your company as it grows? | | | |
| 11 | When you plan reorganisation efforts, do you anticipate and plan for the reaction of stakeholders that will be affected? | | | |
| 12 | Is there a systematic process to communicate changes within the organisation? | | | |
| 13 | In past reorganisation efforts, do you believe your employees understood and shared the vision behind the changes to the organisation? | | | |
| 14 | Do you develop a comprehensive, step-by-step communications plan to educate your employees about the reorganisation efforts? | | | |
| 15 | Does your communication plan include periodic reviews after the launch of the reorganisation? | | | |

*If more than 75% of your answers (12 of 15) are "Yes", your company is addressing the challenge of designing the right organisation. If 50% to 75% of your answers (8 to 11) are "Yes" or "Somewhat", there is more work to be done to design the right organisation. If less than 50% of your answers are either "Yes" or "Somewhat", your company needs to re-evaluate its approach towards designing an organisational structure.*

| | | |
|---|---|---|
| ***Re-evaluate →*** ***0 - 49% →*** | ***→ Needs more work →*** ***→ 50 - 75% →*** | ***→ Ready*** ***→ 76 - 100%*** |

## 6. Further Readings/References


- "Organization Design: Creating Real Value in a Constantly Changing Enterprise" Deloitte Publications. http://www.deloitte.com/dtt/article/0,1002,sid%253D26551%2526cid%253D185446,00.html

- Kezsbom, D. and Edward, K. "The New Dynamic Project Management: Winning Through the Competitive Advantage, Second Edition." 2001.

# The Hong Kong Institute of Directors

# Corporate Governance Toolkit

# Enhance Human Resources Management

Reference and page number in “Guidelines on corporate Governance for SMEs in Hong Kong”

| **Reference number** | **Page** | **Title → subtitle in Guidelines** |
|---|---|---|
| 2.1.4 | 14 | What governance practices do Hong Kong SMEs need? → The Need for Good Governance |
| 2.2.1 | 16 | What governance practices do Hong Kong SMEs need? → Category 1 |
| 2.2.5 | 18 | What governance practices do Hong Kong SMEs need? → Category 1 |
| 2.3.2 (f) | 20 | What governance practices do Hong Kong SMEs need? → Category 2 |
| 2.3.3 (a) | 20 | What governance practices do Hong Kong SMEs need? → Category 2 |
| 2.3.3 (c) | 21 | What governance practices do Hong Kong SMEs need? → Category 2 |
| 2.4.4 (c) | 24 | What governance practices do Hong Kong SMEs need? → Category 3 |
| 2.4.4 (f) | 25 | What governance practices do Hong Kong SMEs need? → Category 3 |
| 2.5.21-22 | 33 | What governance practices do Hong Kong SMEs need? → Category 4 |
| 3.2.2 (b) | 41 | The special issues of family companies → Succession |
| 3.4.2 | 45 | The special issues of family companies → Attracting non-family executives |
| 4.5.3 (d) | 52 | Management practice guidelines → Organising |

Management practice cycle (“Guidelines on corporate Governance for SMEs in Hong Kong” page 8)

| **Cycle Number** | **Management practice cycle** |
|---|---|
| 1 | Planning |
| 2 | Key Performance Indicators (KPIs) |
| 4 | Organising |
| 5 | Leading |

## 1. Overview

Human resources management, which is a specialty within the broader field of management, consists of a framework of activities and practices that support and develop a motivated workforce to achieve company's goals and objectives while at the same time complying with legislation and regulations that govern the employer and employee relationship.

Enhancing human resources management should be the responsibility and a priority of the owner and the management of the company. The complexity of human resources function varies with the size of company. For small and medium companies, the human resources function will be less specialized, whereas for larger companies, the human resources function will be more structured and specialists in different areas, such as recruitment, compensation and benefit, will be required.

## 2. What You Can Do

Human resources management is a broad topic, which consists of mainly nine aspects, know as (1) Human Resources Planning; (2) Recruitment; (3) Compensation and Benefit; (4) Performance Management; (5) Training and Development; (6) Retention; (7) Succession Planning; (8) Termination; and (9) Compliance to laws and regulations.

**2.1. Human Resources Planning.** Regardless of the size of the business, each company should have a human resources budget at certain extent. When developing the human resources budget, management should consider both the current business scale and the future plan of expansion. The human resources budget should be communicated to individual department/functional head and reviewed on a regular basis.

Besides planning for the number of headcount, management should also develop job descriptions for each key position. Job descriptions are basically the profiles of each position, which include the specific location and department of the position, job title, the detail roles and responsibilities and the specific requirements of the position. Job descriptions should be communicated to employees and reviewed on a regular basis to ensure its appropriateness. Through the development of job descriptions, management will be able to clearly identify and understand the requirements of each position, which can facilitate effective recruitment as mentioned in Section 2.2 below. (For sample job descriptions, please refer to Illustration 5.1)

**2.2. Recruitment.** The aspect of recruitment can be further discussed in the following sub-topics:

- **Recruitment Source.** In order to recruit employees with suitable background and experiences that align with the requirements of the position, management should firstly identify the source of recruitment, such as advertising, recruitment agency, job fair, campus recruitment, employee referral, internal transfer, etc. In some cases, management may use the same source or sources for each time of recruitment. However, the requirements of each recruitment and market conditions may change and make these sources less effective. When determining the source of recruitment, management should consider the reach of the source, cost, flexibility, timing and the quality of applicants.

- **Assessment.** When assessing the applicants, management should consider choosing a method or a combination of methods which can truly evaluate the qualities of applicants that align with the job requirement. Assessment criteria should be pre-defined and the assessment result should be documented formally. (For sample recruitment evaluation guide, please refer to Template 5.2) The following are some examples of assessment methods:

- **Screening of résumés.** Screening of résumés is the initial assessment step and management should pay special attention to education and professional qualification, pattern of short-term employment, employment gaps, job progression and language ability of the applicants.

- **Interview.** Interviewing applicants is the most common and direct method of assessing the ability and inter-personal skill of the applicant. Interviewers should be well-prepared and structure the interview so that questions put to the applicants are both a means of controlling the interview and eliciting the information you need to effectively evaluate the prospective applicant.

- **Group discussion.** Having group discussion can enable the management to assess the leadership skill and inter-personal skill of the applicants via interactions within the group.

- **Test.** Different type of tests, such as written test, aptitude test, can be designed in accordance with the job requirements. This is a direct assessment of the technical and written ability of the applicants.

- **Reference check.** Reference checks verify claims made by the applicants during the other assessment process and fill in information gaps. They can also provide valuable outside perspectives on the applicants and their potential fit with the position.

- **Employment contract.** Employment contract is the contractual agreement between the employer and the employees. An employment contract should at least include terms and conditions indicating the basic salary, benefit, holiday entitlement, types of employment, non-disclosure agreement, etc. The terms and conditions of the employment contract should be aligned with local labour laws and regulations and the standard template should be reviewed by legal adviser.

- **Orientation.** Orientation program is an essential process that assists the new hires to become familiar with the surroundings and develop an understanding of the company and departmental expectations. An orientation program should include the introduction of company's structure, goals and business objectives, code of conduct, standards of performance, policies and procedures and a description of benefits and employee services. Management should consider developing an employee handbook to incorporate the above content and distribute to all employees.

**2.3. Compensation and Benefit.** Compensation and benefit are not only expenses of the company; they also have direct impact to the quality of the workforce and the company's ability to attract and retain talents.

Compensation is usually referring to salary and bonus, which can be calculated in fixed term basis, time basis, piecework basis or performance basis. When designing the compensation program, management should:

- Conduct a position evaluation by understanding the work, skills and experiences requirements of each position;

- Determine the structure of the compensation program, below are some of the examples of compensation programs:

- **Fixed-based:** Fixed rate of compensation for performing standard duties and tasks;
- **Skill-based:** Determine compensation based on the level and proficiency of employees' skills, rather than for the specific job performed;
- **Competency-based:** Determine the traits that contribute to the success of job performance and compensate employees by measuring how well they meet the established traits;
- **Merit-increase system:** Determine the salary ranges of different positions or groups of position and compensate employees based on performance; and

- Communicate the compensation program structure to all employees and review its appropriateness on a regular basis for changes in business environment.

Benefits are special rewards that are offered to employees in addition to their base salary, such as insurance, stock options, housing allowance, etc. In general, there are two types of benefit program:

- **Traditional benefit program:** It usually limits employees to two choices, that is to participate in the program or not. The plan generally affords uniform types and amounts of coverage; and
- **Flexible benefit program:** It is a system that allows employees to choose from a range of benefit programs given a maximum allowance amount. A flexible benefit program can relatively improve employee morale by adapting to individual needs. However, it will also be more complicated to administer.

When evaluating the effectiveness of compensation and benefit programs, management should determine whether they are:

- Comparable to external market;
- Internally equitable;
- Compliance with laws and regulations;
- Supported by senior management and employees;
- Contribute to motivating employees; and
- Easy to administer and flexible for change.

**2.4. Performance Management.** The primary objectives of performance management are to develop mutual understanding of management and employees regarding to performance expectations; providing feedback on past performance and identifying future improvement areas. An effective performance management system will enable management to align compensation programs and promotions with employees' performance, identify training needs and utilize employees more effectively. On the other hand, employees can also benefit through a better understanding of management's expectation, their roles and responsibilities and development areas. Ultimately, an effective performance management system can enhance a company to achieve its goals and objectives by motivating the whole workforce.

When designing and establishing a performance management system, management can consider choosing from one or a combination of the following methods:

- **Self-evaluation:** This method allows employees to evaluate their own performance and compare that with management's evaluation. This method can facilitate the understanding of expectation gap between management and employees.

- **360-degree evaluation:** Besides self-evaluation and management's evaluation, this method requires more evaluations from different sources, such as peers, sub-ordinates, clients and suppliers. This method can provide a relatively more objective and thorough evaluation than traditional method.

- **Rating scale:** Under this method, different job-related attributes, such as technical skills, inter-personal skills, conduct, etc., are assigned with a rating scale. Each attribute can be assigned with weightings in accordance with the importance to the job nature and scores should be assigned to the rating scale, which facilitate comparison and ranking of employees as stated below.

- **Ranking:** Under this method, management is required to compare employees and assign rankings to them. This method allows management to match employees' performance with compensation program and facilitate promotion decision.

Regardless of the type of performance management system that the company has designed and implemented, the performance appraisal results of all employees should be documented and maintained. (For sample performance appraisal form, please refer to Template 5.3)

When determining the structure of the performance management system, management should ensure that it is:

- Align with the culture of the company and nature of the business and job requirements;

- Supported by and communicated to senior management and employees;

- Reliable, which can generate consistent data over different time periods;

- Incorporate both qualitative and quantitative evaluation criteria; and

- Standardized across different departments and promote fairness.

**2.5. Training and Development.** In recognition of the importance and the belief that better-educated employees improve the ability of a company to succeed, the training and development of employees is generally viewed as a benefit to both employees and the company. In order to develop an effective training and development program, management should:

- **Identify training needs.** Before designing the training program, management should identify the training needs of employees via observation, employee surveys or focus groups. In some cases, training needs may be a result of the change in external environment, such as advance in technology or change in customer requirements. During such process, management must ensure that the training needs identified must be align with the company's strategy and business objectives.

- **Evaluate training options.** The objective of evaluating training options is to ensure that training needs identified can be addressed in the most cost effective way. The most common training options are class-room training, public seminar, e-learning, training workshops, etc. When evaluating the options, management should consider the number, job level, background and experiences of trainees and the costs associated with the options.

- **Design and implement the training program.** When designing and implementing the training program, management should consider the learning style of trainees, the applicability of the subject matter, the quality of trainer, the duration and timing of the training program. However, the most important thing is that management should establish a learning environment for the company; and communicate to employees that the training program is fully supported by management and crucial to the growth and development of both the employees and the company.

- **Evaluate the results.** After conducting the training program, management should evaluate the results of the training. Evaluation questionnaire should be given to the attendees after the training program in order to collect feedback for further improvement. Management can also consider designing tests for employees to assess their knowledge and understanding after the training program. In addition, management can also evaluate the results of the training via observation of the changes in employees' job performance.

**2.6. Retention.** It is common to say that the best form of recruitment in today's business environment is retention. This may be particularly crucial for SMEs and family owned companies, whose operation and success rely on a small number of employees and management. Effective retention program can increase customer satisfaction and product sales; and promote operational efficiency and effectiveness and reduce costs associated with turnover. Retention can be understand in two aspects, as follow:

- **General retention program:** This type of retention program applies to the whole company and its objective is to retain all employees regardless of job nature and position.

- **Specific retention program:** This type of retention program applies only to a specific segment of employees. This segment of employees, who is considered to provide high-value to the company, is usually provide leadership to others, consistently generate good results, has unique knowledge or skills that are difficult to replace and can create great harm to companies if defected to competitors.

Retention program is closely related to compensation and benefit plan and performance management system of the company and some of the suggested methods are as below:

- **Establish a fair and attractive compensation plan,** which is aligned with job performance. It may not be necessary to increase salary significantly higher than the market. The essence of an attractive compensation plan is to meet the needs of employees.

- **Conduct job re-design or job rotation** can improve job satisfaction by providing employee opportunities for further development and better career aspiration.

- **Strengthen social ties** among employees by organizing interest groups and gathering function. This can help to promote sense of loyalty and a friendly working environment.

**2.7. Succession Planning.** Succession planning is the process that helps a company to plan for talents to assume key leadership role on a permanent or temporary basis. The objective of succession planning is to ensure continuity of business operation in order to achieve the company's goals and objectives. Besides addressing such primary objective, succession planning can also provide increased opportunities and clear career prospects for outstanding employees and increase employee morale.

Succession planning may have significant impact to individual employee's career path. Management should consider implementing one of the following succession plans:

- **Open succession plan:** Under an open succession plan, the requirements and outcomes of the plan are communicated to the participated employees. This will increase the sense of loyalty and morale of the employees. But the management must clearly communicate to employees that this is not a guarantee of career advancement in order to avoid the negative impact of unrealistic expectation.

- **Closed succession plan:** Under a closed succession plan, the details of the plan is only limited to a "need-to-know" basis. Details relating who is chosen and the development procedures may not be communicated to the identified employees. The rationale behind is that succession issues may involve sensitive information in relation the company's strategy and development

When establishing a succession plan, management should:

- **Identify the need of succession plan:** Management should identify which positions in the company should be involved in the succession plan. Positions included may not be necessary be a managerial position. It can be any key position, such as research and development specialist or chief designer, which is critical to the success and continuity of the company in accordance with its business nature.

- **Identify the talent pool:** After identifying the key positions, management should determine the requirements of these positions and determine the respective talent pool, which has potentials for further development.

- **Engage the participants:** After identifying the talent pool, individual development program should be designed for these identified employees. The development program should include learning paths and milestones that incorporate coaching, on-the-job training and classroom training. These identified employees should be given opportunities to perform certain tasks of their targeted positions.

- **Monitor the succession plan:** The succession plan should be reviewed on a regular basis and revised based on the change of business environment. The progress of the succession plan should also be reviewed to ensure identified employees' development meet management's expectations.

**2.8. Termination.** Termination is the separation of the employee from the company. Such termination can be voluntary and involuntary. Voluntary termination means the resignation initiated by employees. Involuntary termination is initiated by the employer. During the termination process, management should consider:

- **Notice of termination.** The notice of termination should be given to employees in accordance with the employment terms. The effective date of termination should be indicated in the termination letter. If the effective date is shorter than the notice period, the company should compensate the employee in accordance with the employment terms.

- **Final payment.** The calculation of final payment should be in accordance with the employment terms and local laws and regulations, which includes salary (pro-rated to the date of termination), severance payment, outstanding expense reimbursement and money due by virtue of accrued vacation and overtime payment. Final payment should be given to employees on the last day of employment.

- **Termination checklist.** A termination checklist should be prepared by management and include all items relating to the termination process, such as return of company's properties (e.g. access card and computer), suspension of office and system access right, distribution of final payment, suspension of insurance coverage, removal of employee from payroll master file, exit interview, etc. (For detail, please refer to Template 5.4)

- **Exit interview.** An exit interview should be conducted with employee before the last day of employment. The purpose of an exit interview is mainly to discuss the reasons of resignation and the employee's comments about the company. Comments gathered from exit interviews are a valuable source of information for improving working conditions and retaining employees. (For sample exit interview questions, please refer to Illustration 5.5)

**2.9. Compliance to laws and regulations.** One of the critical components of a good human resources practice is to comply with laws and regulations. Non-compliance may increase the risk of law suits and penalty. Major labour legislation in Hong Kong includes Employment Ordinance, Factories and Industrial Undertakings Ordinance, Employee's Compensation Ordinance and Occupational Safety and Health Ordinance. Management should ensure that the company's human resources policies and procedures should be aligned with the legal requirements and there should be a process in place to monitor the changes of these laws and regulations. Legal advice should be obtained if necessary.

## 3. Benefits/Limitations

**3.1. Benefits.** Enhancing human resources practices is beneficial to the entire company since human capital is for many companies its most valuable asset. The most important benefits can be an increased appeal of the company in the labour market, improved morale among employees, staff loyalty, and reduced costs associated with turnover and training.

**3.2. Limitations.** Even though enhancing the human resources practices provides substantial benefits, it is important to understand that it can be costly and time consuming, for it not only involves developing policies and procedures, but also including process re-design and developing a corporate culture. During the enhancement process, management should set up priorities and avoid implementing all changes at the same time, since it takes time to change a corporate culture and obtain support from both management and employees.

## 4. Considerations for Business in Mainland China

When developing and enhancing the human resources management practices for business in Mainland China, management should consider the requirements of the local laws and regulations. Management should also pay special attention to the minimum wage, overtime, leave, child labour, withholding tax and welfare policies of the laws and regulations of different provinces. In Mainland China, employers and employees are required to contribute to the social security insurance with compensation for retirement, illness, work related accidents, unemployment, death and maternity. In addition, employers and employees are required to contribute for the establishment and operation of labor unions.

## 5. Tools, Templates and Illustrations

### Illustration 5.1: Sample Job Descriptions

**Sample Job Descriptions**

| | |
|---|---|
| **Position:** | **Marketing Manager** |
| **Location:** | **Hong Kong SAR** |
| **Department:** | **Marketing** |
| **Reference Code:** | **XXX** |
| **Type of Position:** | **Full-time** |

**Job Descriptions**

**Key objectives**

1. Lead marketing strategy development and execution to raise the profile, build eminence of the company, to facilitate winning of new clients and retention and growth of business from existing clients.

2. Support different service/product lines of the company on their needs for marketing, communications and business development support services.

3. This position reports directly to the Marketing Director and will need to work closely with the management of different service/product lines.

**Key responsibilities**

1. Develop a differentiated and relevant market positioning for the company's practice in Asia Pacific.

2. Develop and execute of segmented marketing programs including events and communications.

3. Develop and manage appropriate sponsorship opportunities.

4. Develop and manage marketing materials and platforms including brochures, thought leadership reports, articles, client communications, website, intranet.

5. Manage clients' data for effective client relationship management.

6. Provide marketing and communications services to support different service/product lines with the execution of their client service plans for key accounts.

**Requirements**

1. Degree or above in Business Administration, Marketing or related disciplines
2. Minimum 6 years' relevant working experience, preferable previous experience in telecommunication industry and MNC environment
3. Writing and editing marketing materials
4. Brand management
5. Sponsorship management and event management
6. Business proposals and presentations development or support
7. Project management (people, process, time and budgets)
8. Experience of the Asia Pacific markets
9. Excellent written and spoken English, (Chinese a definite advantage)
10. Excellent interpersonal skills and able to work independently and multi-tasking

**Template 5.2: Recruitment Evaluation Template**

| | | |
|---|---|---|
| **Date:** | | |
| **Applicant name:** | | |
| **Contact number:** | | |
| **Position applied for:** | | |
| **Availability:** | | |
| **Evaluated by:** | HR | Name:<br><br>Date: |
| | 1st Interviewer | Name:<br><br>Department:<br><br>Date: |
| | 2nd Interviewer | Name:<br><br>Department:<br><br>Date: |

**GUIDANCE TO INTERVIEWER**

- Familiarize yourself with the candidate's Application or CV/Resume.
- Greet the applicant giving your name and position and explain that the purpose of the interview is to assess whether the applicant is competent and suitably qualified to perform the inherent requirements of the job.
- In case of a panel interview introduce the member of the panel by name and position.
- Start out the interview on a positive note. Thank the applicant for meeting with you. Tell the candidate what impressed you about their resume/CV or application.
- During the interview process, you should:
    - Provide information on position and overview of the Company
    - Ask questions to gain specific information from the candidate – probe for real examples/ situations.
    - Listen to what the candidate says when they explain their actual behavior/involvement.
    - Explain that you will be taking notes to maintain a level of consistency and for the record purposes.
    - Give candidate the opportunity to ask any questions about the company and position at the end of the interview.
- Document the evaluation result using the following rating system:

**Determine and record the rating in the rating box for each evaluation dimension. Use the following system:**

- 5-Significantly exceeds criteria for successful job performance
- 4-Exceeds criteria for successful job performance
- 3-Meets criteria for successful job performance
- 2-Generally does not meet criteria for successful job performance
- 1-Significantly below criteria for successful job performance

### 1. WORK HISTORY

Go through the application or resume/CV and confirm any outstanding/unclear information. Record comments or things to follow up.

| | | | | | |
|---|---|---|---|---|---|
| **Sample Questions** | 1. Ask about any gaps or unclear information presented in the candidate's resume/CV or application.<br>2. What aspects of your current job do you find most satisfying?<br>3. How has your education and experience prepared you for this position?<br>4. Why are you planning on leaving your current job? | | | | |
| **Comments** | **1st Interviewer:**<br><br>**2nd Interviewer:** | | | | |
| **Rating** | | | | | |
| **1st Interviewer** | 1 | 2 | 3 | 4 | 5 |
| **2nd Interviewer** | 1 | 2 | 3 | 4 | 5 |

### 2. PROFESSIONAL/TECHNICAL KNOWLEDGE

Understand whether the candidate has sufficient skills/knowledge to fulfill the technical requirements of the position.

| | | | | | |
|---|---|---|---|---|---|
| **Sample Questions** | 1. Ask some sample technical questions in relation to the position.<br>2. What is the greatest challenge in relation to the position and understand how the candidate resolves the problems. | | | | |
| **Comments** | **1st Interviewer:**<br><br>**2nd Interviewer:** | | | | |
| **Rating** | | | | | |
| **1st Interviewer** | 1 | 2 | 3 | 4 | 5 |
| **2nd Interviewer** | 1 | 2 | 3 | 4 | 5 |

### 3. UNDERSTAND CLIENT NEEDS

Understand whether the candidate has sufficient knowledge, skills, and experiences to build up and maintain strong client relationships and deliver outstanding service.

| | | | | | |
|---|---|---|---|---|---|
| **Sample Questions** | 1. Who are your key clients? What industry you are specialized in?<br>2. What skills or qualities are important for dealing effectively with clients? Please give an example of when you displayed these skills or qualities.<br>3. How do you identify the additional needs for the clients? Please give an example of when you displayed this. | | | | |
| **Comments** | **1st Interviewer:**<br><br>**2nd Interviewer:** | | | | |
| **Rating** | | | | | |
| **1st Interviewer** | 1 | 2 | 3 | 4 | 5 |
| **2nd Interviewer** | 1 | 2 | 3 | 4 | 5 |

### 4. MANAGEMENT EFFECTIVENESS

Understand whether the candidate has experiences and skills to work as or supervise teams.

| | | | | | |
|---|---|---|---|---|---|
| **Sample Questions** | 1. What is the size of team(s) that you managed/worked for?<br>2. Tell me about a time when you had to champion a change, popular or unpopular. How did you handle it?<br>3. What do you do to promote teamwork in order to attain your goals? Please give me an example.<br>4. Describe a situation where you had to be creative in motivating your colleagues? | | | | |
| **Comments** | **1st Interviewer:**<br><br>**2nd Interviewer:** | | | | |
| **Rating** | | | | | |
| **1st Interviewer** | 1 | 2 | 3 | 4 | 5 |
| **2nd Interviewer** | 1 | 2 | 3 | 4 | 5 |

### 5. COMMUNICATION

Evaluate the candidate's communication and language skills. (e.g. English/Chinese/Mandarin)

| | | | | | |
|---|---|---|---|---|---|
| **Sample Questions** | 1. Throughout the interview, require the candidate to answer questions in different languages. | | | | |
| **Comments** | **1st Interviewer:**<br><br>**2nd Interviewer:** | | | | |
| **Rating** | | | | | |
| **1st Interviewer** | 1 | 2 | 3 | 4 | 5 |
| **2nd Interviewer** | 1 | 2 | 3 | 4 | 5 |

### 6. CAREER ASPIRATIONS

Understand the candidate's career goals and aspirations.

| | |
|---|---|
| **Sample Questions** | 1. What is your career goal?<br>2. How will you position yourself in the coming 5 years? |
| **Comments** | **1st Interviewer:**<br><br>**2nd Interviewer:** |

| **Rating** | | | | | |
|---|---|---|---|---|---|
| **1st Interviewer** | 1 | 2 | 3 | 4 | 5 |
| **2nd Interviewer** | 1 | 2 | 3 | 4 | 5 |

### EVALUATION SUMMARY

| **Other comments:** |
|---|
| |

| **Overall Rating** | | | | | |
|---|---|---|---|---|---|
| **1st Interviewer** | 1 | 2 | 3 | 4 | 5 |
| **2nd Interviewer** | 1 | 2 | 3 | 4 | 5 |

| **Conclusion** | |
|---|---|
| **1st Interviewer** | **Recommend for 2nd interview?**<br>**Yes** **No** |
| **2nd Interviewer** | **Recommend for job offer?**<br>**Yes** **No** |

### Template 5.3: Performance Evaluation Form Template

**GENERAL GUIDANCE**

This performance appraisal form links to the competencies expected from you to your actual performance. The principal objective of the evaluation is to assist your career development by identifying strengths and areas for improvement.

***Counselee:***

1. At the beginning of each fiscal year, please fill in the career goal and roles and responsibilities in Sections 2 & 3 by discussing the details with your counselor.

2. During the appraisal meeting, please re-visit your career goal and roles and responsibilities with your counselor and complete the Sections 4-6.

3. After the completion of this form, please seek approval from your counselor and your department head.

***Counselor/Department Head:***

1. At the beginning of each fiscal year, please discuss the career goal and roles and responsibilities with your counselee.

2. During the appraisal meeting, please re-visit the counselee career goal and roles and responsibilities and complete Sections 4-6.

3. After the completion of this form, please sign the form and submit it to Human Resources Department for filing purpose.

***Human Resources Department:***

1. Collect the performance appraisal form at the end of each fiscal year.

2. File the performance appraisal form in the employee record.

**Determine and record the rating in the rating box for each competency dimension. Use the following system:**

- 5 – Significantly exceeds expectation
- 4 – Exceeds expectation
- 3 – Meets expectation
- 2 – Meets some expectation
- 1 – Significantly below expectation
- N/A – Not applicable

**Section 1 – Personal Data**

| | |
|---|---|
| **Employee Name:** | **Employee Position:** |
| **Staff Code:** | **Department:** |
| | |
| **Counselor Name:** | **Counselor Position:** |
| | |
| **Appraisal Period:** | **Date of Meeting:** |

**Section 2 – Career Goal**

| **Career Goal** | **Target Date** |
|---|---|
| | |
| | |

**Section3 – Roles and Responsibilities**

| **Roles and Responsibilities** | **Target Date** | **Achieved? (Y/N) **** |
|---|---|---|
| | | |
| | | |
| | | |
| | | |

** Please fill in by Counselor at the end of the fiscal year and discuss with counselee during the performance appraisal meeting.

**Section 4 – Detail Performance Appraisal**

| | **Counselee Self-Evaluation** | | | | | | **Counselor Evaluation** | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Competency** | **N/A** | **1** | **2** | **3** | **4** | **5** | **N/A** | **1** | **2** | **3** | **4** | **5** |
| | | | | | | | | | | | | |
| | | | | | | | | | | | | |
| | | | | | | | | | | | | |
| | | | | | | | | | | | | |

**Section 5 – Comments**

| **Counselee Self-Comments** |
|---|
| **Counselee's Strengths** |
| **Counselee's Improvement Areas** |

| **Counselor Comments** |
|---|
| **Counselee's Strengths** |
| **Counselee's Improvement Areas** |

**Section 6 – Summary**

| **Overall Rating** | |
|---|---|
| Counselee Rating | 1 2 3 4 5 |
| Counselor Rating | 1 2 3 4 5 |

| **Approval** | **Signature** | **Date** |
|---|---|---|
| Counselee Name: | | |
| Counselor Name: | | |
| Department Head Name: | | |

### Template 5.4: Termination Checklist Template

#### Termination Checklist (Sample)

Name: _____
Staff Number: _____
Department & Position: _____
Joining Date: _____
Terminating date: _____

**Purpose:** The following checklist is provided to HR Department to process the termination of employees. The checklist should be completed prior to employee's last day of work.

| | Items | Responsible Department | Sign off (with department chop) | Date |
|---|---|---|---|---|
| **POSITION DUTIES** | | | | |
| 1 | Letter of resignation | Respective Dept and HR | | |
| 2 | Communicate status of pending works | Respective Dept | | |
| 3 | Return relevant files and documents | Respective Dept | | |
| **EXIT INTERVIEW** | | | | |
| 4 | With Human Resources Department | HR | | |
| **PHYSICAL SURROUNDINGS** | | | | |
| 5 | Clear files and personal items from workstation & tidy desk & cubicle area | Respective Dept | | |
| 6 | Take or discard name plate | Respective Dept | | |
| 7 | Return unused office supplies | Respective Dept | | |
| 8 | Return Key(s) – desk/building/office/file cabinets/ cars | Respective Dept | | |
| 9 | Return materials borrowed from library/filling room | Library/Filling Room | | |
| 10 | Return access/ID card | HR | | |
| 11 | Return credit card(s) | Finance | | |
| **TECHNOLOGY** | | | | |
| 12 | Return computer & corresponding components | IT | | |
| 13 | Disable system user account and access rights | IT | | |

| | | | | |
|---|---|---|---|---|
| **PAYMENTS** | | | | |
| 14 | Settlement of all outstanding petty cash amounts due or travel advances | Finance | | |
| 15 | Distribute final payment and obtain receipt acknowledge from employee | Finance | | |
| Signature of Department Head:<br><br>Date: | | | | |
| Remarks: | | | | |

**Illustration 5.5: Sample Exit Interview Questions**

**Exit Interview Questions (Sample)**

1. What is your primary reason for leaving?
2. Did anything trigger your decision to leave?
3. Are you dissatisfied with your job? Why?
4. What would you change about your job?
5. Did your job duties turn out to be as you expected?
6. Did you receive enough training to do your job effectively?
7. Did you receive sufficient feedback about your performance between performance reviews? Any improvement suggestion for the current performance management system?
8. What would you improve to make our workplace better?
9. Were you satisfied with your pay, benefits and other incentives?
10. What was the quality of the supervision you received?
11. Did any company policies or procedures (or any other obstacles) make your job more difficult?
12. Would you consider working again for this company in the future?
13. Would you recommend working for this company to your family and friends?
14. What did you like most about this company?
15. What did you like least about this company?
16. What does your new company offer that this company doesn't?
17. Can this company do anything to encourage you to stay?
18. Before deciding to leave, did you investigate a transfer within the company?

## 6. Further Readings/References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# The Hong Kong Institute of Directors

# Corporate Governance Toolkit

# Manage Risk

Reference and page number in “Guidelines on corporate Governance for SMEs in Hong Kong”

| **Reference number** | **Page** | **Title → subtitle in Guidelines** |
|---|---|---|
| 2.1.10 (d) | 16 | What governance practices do Hong Kong SMEs need? → The need for good governance |
| 2.2.2 (d) | 18 | What governance practices do Hong Kong SMEs need? → Category 1 |
| 2.3.2 (d) | 19 | What governance practices do Hong Kong SMEs need? → Category 2 |
| 2.4.3 (c)-(d) | 24 | What governance practices do Hong Kong SMEs need? → Category 3 |
| 2.4.4 (c) (iv) | 25 | What governance practices do Hong Kong SMEs need? → Category 3 |
| 2.5. 27 | 34 | What governance practices do Hong Kong SMEs need? → Category 4 |

Management practice cycle (“Guidelines on corporate Governance for SMEs in Hong Kong” page 8)

| **Cycle Number** | **Management practice cycle** |
|---|---|
| 1 | Planning |
| 3 | Operations/Implementation |
| 6 | Controlling |

# 1. Overview

Risk can be defined as the threat that an event or action will occur or fail to occur, adversely affecting a company's ability to achieve its business objectives and execute its strategies. Risk is an aspect of any company's operation. When it is recognized, understood, and managed, risk can set the stage for sustainable growth. On the other hand, if risk is not properly managed, it will increase the company's possibility of failure.

For SMEs, identifying and minimizing risk while pursuing a high-growth strategy is a difficult task. Below are some of the challenges faced by SMEs in relation to risk management:

- **The fear of incurring risk inhibits growth.** Above average and sustainable growth can be achieved only through the successful management of risks. Companies striving for this level of performance have to pursue strategies not considered the norm in their industry. This requires a systematic process to measure, assimilate, and lessen the risk associated with aggressive strategic initiatives.

- **Market complexity magnifies exposure to risk.** Alliances or partnerships provide scale and access to markets, intelligence, and competencies that companies would otherwise have to develop in-house. While alliances or partnerships have significant benefits, they are also prone to failure, which can result in a loss of direct control. This greatly increase companies risk profiles and vulnerability, as they may become accountable for their partner's actions.

- **Risk becomes more complex as companies grow.** To scale their operations effectively, companies need formal structures and a decentralization of activities. As companies become more complex, the interdependence of risks increases. Decisions made in one part of the company could adversely affect business processes in another, causing decline in overall performance.

In order to address the above challenges, it is essential for SMEs to develop a risk management process which helps them to balance their risk and rewards, and mitigate the obstacles to achieving their strategic goals.

# 2. What You Can Do

The suggested risk management approach is divided into three phases: (1) Plan the Risk Management Effort, (2) Identify and Assess Risk and (3) Manage Risk. For the illustration of this approach, please refer to Illustration 5.1 for detail.

## 2.1. Plan the risk management effort

- **Establish a risk management mindset.** Risk is inherent in any business activity, but it is intensified by the characteristics of growth-oriented companies. A company's willingness to accept risk is determined by its risk tolerance as influenced by the preference of its stakeholders. Traditional risk management strategies have typically addressed and mitigated specific risks in relative isolation. The reasons for this are that a company's focus has traditionally been on mitigating harmful effects on assets in place and has been functionally focused. Viewing risk management from a functional perspective results in the creation of informal preventive measures that are unrelated to operations in other areas of the company. However, since companies today are undergoing rapid growth and are more complex, they need to view risk management from an enterprise-wide perspective. Companies need to take into account various sources of risks and the enterprise-wide implications of these risks. By developing the enterprise-wide risk management mindset, companies are able to manage their existing assets in place via preventive control activities and also optimize their decisions and choices to enable growth opportunities.

- **Determine corporate risk/return objectives.** Risk can be viewed as the possibility of suffering harm or loss as a result of corporate decisions. The first step in creating processes to manage negative outcomes is to find the right balance between risk and returns and to formulate objectives that will guide decision-making. To determine corporate risk/return objectives, companies need to expand their risk tolerance analysis by taking the following factors into account:

  - Investor and other stakeholders preferences and expectations;
  - Risk culture of the company and of the industry;
  - Availability of capital to support strategic objectives;
  - Differential in net rewards between high risk and low risk activities;
  - The availability of expertise to manage risk; and
  - Previous experience and success in managing risk.

  Risk/return objectives need to articulate a commitment to risk management activities. These objectives should communicate priorities and provide a context for the management policies that guide decision-making. Specific examples are:

  - Monetary limits (e.g. financial loss limits, maximum investments and transaction limits); and
  - Transactions or activities which are encouraged or prohibited.

- **Create the risk management steering committee.** A risk management initiative may lead to a change in management effort and obtaining support from management is crucial. Therefore it is suggested that management should formulate a steering committee that reports directly to CEO or the board of directors and functions as a visible sponsor of the risk management initiative. The roles and responsibilities of the steering committee should be clearly defined. It should be responsible for developing a risk-awareness mindset in the company and creating the processes and structures that influence the risk management culture. In addition to the steering committee, the company should also identify risk managers in existing functional, structural and geographical organizational structures. These risk managers should report to the steering committee and be responsible for monitoring management practices and controls, and be empowered to detect, communicate, mitigate and follow-up on significant risk vulnerabilities within the company. For an example of the risk management steering committee structure, please refer to Illustration 5.2.

### 2.2. Identifying and assess risks.

- **Identify risk.** The risk identification process is to generate a comprehensive list of risks for each area of the company. In addition, management should also understand the root causes of each risk. The risk identification process should include inputs of representatives from all areas of the company. This can be conducted via workshops, surveys, and training programs. The process of risk identification should be aligned with a company's objectives and strategic plans. Management should identify risks based on its knowledge of both the external environment in which the company operates as well as an understanding of the company's internal capabilities. Risk identified can be classified into the following categories (for examples, please refer to Illustration 5.3):

- **Market risks:** Market risks are those associated with the achievement of a company's long-term strategic objectives, generated largely by the uncertainty of the external environment and its four key drivers: markets, competition, technology, and regulation. Typically, its impact will be substantial and the ability for a company to control the risk is limited.

- **Financial risks:** Financial risks are associated with the financial structure of the company, the transactions that the company makes, and the financial systems already in place.

- **Operational risks:** Operational risks are associated with the company's operational and administrative procedures. These may include recruitment, supply chain management, information systems and production procedures.

- **Compliance risks:** Compliance risks are those associated with the need to comply with laws and regulations. They also apply to the need to act in a manner which investors and customers expect; for example, by ensuring proper corporate governance.

- **"Force majeure" risk:** These risks include natural events such as natural disasters that profoundly affect a company's operation, suppliers and customers. Companies have no control over the occurrence and have limited measures, such as establishing a disaster recovery plan, to mitigate the impact.

- **Evaluate risk.** Evaluation of risk involves providing the necessary information to enable companies to differentiate between major and minor risks and to assist in the subsequent evaluation of risk management options. Risk evaluation can be conducted via interviews, questionnaires and workshops. Risks are evaluated by the following two risk criteria:

  - **Impact:** Risk is measured in terms of the impact that event would have on the organization. Impact of risks can be assessed by the following categories:

    — Financial

    — Reputation

    — Legal/regulatory

    — Customer/business partner

    — Employees

    — Strategic

    — Operational

    — Investor

- **Vulnerability:** Vulnerability relates to the measurement of susceptibility level of risks. When we determine the vulnerability of risk factors, we need to determine whether the company has internal control procedures or systems in place to mitigate the risk factors and whether such internal control activities are properly designed and effective. Vulnerability of risks can be assessed by the following categories:

  — Control effectiveness and efficiency

  — Previous risk experience

  — Complexity

  — Risk management capability

  — Rate of change (expansion/contraction)

- **Prioritize risk.** After evaluating the risks by the above two risk criteria, management can develop a risk ranking table. For details, please refer to Illustration 5.4.

### 2.3. Manage the risk

- **Develop risk management options.** To mitigate the identified risks, several risk management options should be developed. These options should consist of actions that may include modifying a company's operations, employing financial instruments and designing and implementing internal controls. There are four principal approaches to mitigating the identified risks:

  - **Change:** Changing the impact and vulnerability of the risk, to reduce the extent of the losses and strengthening internal controls procedures or systems.

  - **Transfer:** This may involve other parties bearing or sharing some part of the risk, such as using contracts, insurance arrangements, partnerships and joint ventures to spread responsibility and liability.

  - **Avoid:** Avoid the risk by deciding not to start or continue with the activity that gives rise to the risk.

  - **Retain:** After risks have been changed or transferred, there will be residual risks that are retained. Risks can also be retained by default, e.g. when there is a failure to identify the most effective risk mitigation option.

- **Select and implement options.** Selecting the most appropriate option involves measuring the cost of implementation against its expected benefit i.e. the reduction in risk. The cost effectiveness of each option is simply the expected benefits less the expected costs. To measure the benefit of each option, companies must estimate the expected risk impact assuming no risk management actions are taken, and subtract the expected risk impact assuming that the risk management option is implemented. The cost of managing the risk should include the initial capital expenditure as well as the ongoing operating costs of the option.

  A graphic illustration of a company's assessment of risk management options can illustrate the effects of cost and benefits. For detail, please refer to Illustration 5.5. On the left of the

indifference line are the favourable options where benefits are greater than costs, whereas the right hand side of the indifference line represents unfavourable options where costs are greater than benefits. Although in some cases, costs and benefits of a risk management option cannot be quantified, management should still evaluate the options following this concept. This can provide a preliminary screening of options and can assist companies in understanding how various options may interact.

- **Monitor and review risk management performance.** Risk management should be an on-going process. Evaluation of the risk management process must be undertaken periodically to ensure that company's objectives are being achieved. The monitoring process should provide assurance that there are appropriate controls in place for the company's activities and that the procedures are understood and followed. Any monitoring and review process should also determine that:

    - The measures adopted resulted in what was intended;
    - The procedures adopted and information gathered for undertaking the assessment were appropriate;
    - Improved knowledge helped to reach better decisions; and
    - The process provided the basis for future assessment and management of risk.

    As companies and the environments in which they operate change, appropriate modifications must be made to implemented risk management options. The review and monitoring process ensures that risk management processes can be adapted as required.

## 3. Benefits/Limitations

**3.1. Benefits.** Implementing systematic risk management can assist company to identify and manage the potential events or actions that may adversely affect the company to achieve its objectives and implementing its strategies, which ultimately increase the company's chances of success and reduce the possibility of failure. Companies that are better at identifying and managing risk will be better prepared and have a more cost-effective way of dealing with it.

**3.2. Limitations.** Implementing risk management program requires inputs from the company's resources and management effort. In some cases, the cost of implementing a sophisticated risk management program may outweigh the benefits received. In addition, risk management program cannot ensure that a company eliminates or mitigate all the risks since some of the risks, such as natural disasters and political instability, cannot be controlled and managed by the company.

## 4. Considerations for Business in Mainland China

When identifying and assessing risks for business in Mainland China, management should consider the differences in political, legal, economic and social factors. Many companies in Hong Kong have established plants or branches in Mainland China, as a result, management should consider whether they are affected by environmental issues, such as risks associated with earthquake, floods, shortage of electricity supply, etc. Rules and regulations governing different industries are relatively complex and changed more frequently. This will also increase the risk of compliance to those rules and regulations. Hong Kong business in Mainland China will also be affected by the risks associated with foreign currency control and the fluctuations of RMB. As a result, management should establish and implement certain financial controls to mitigate these risks.

## 5. Tools, Templates and Illustrations

**Illustration 5.1: Risk Management Approach**

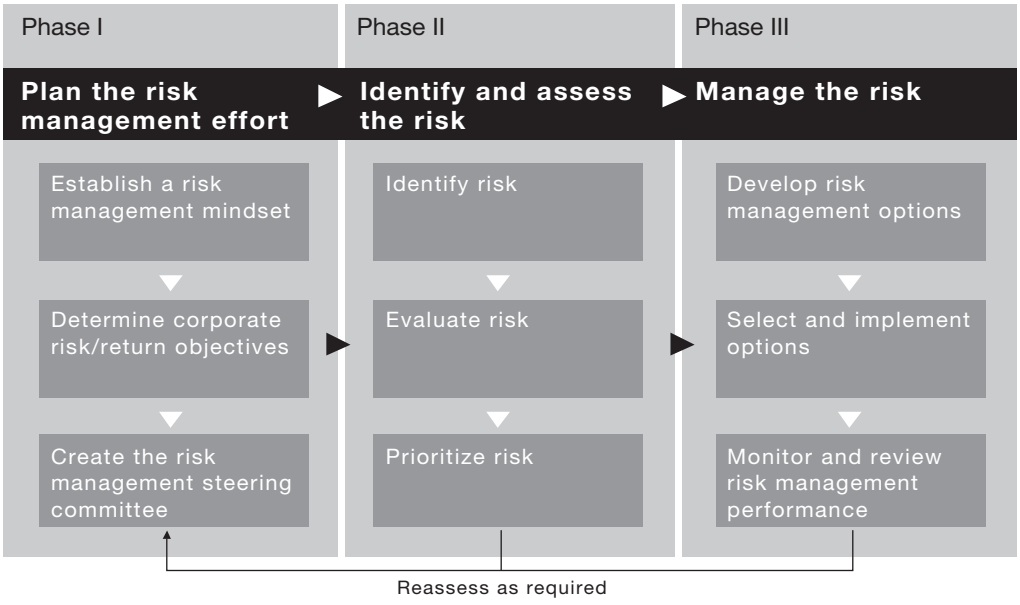


**Illustration 5.2: Risk Management Steering Committee Structure Example**

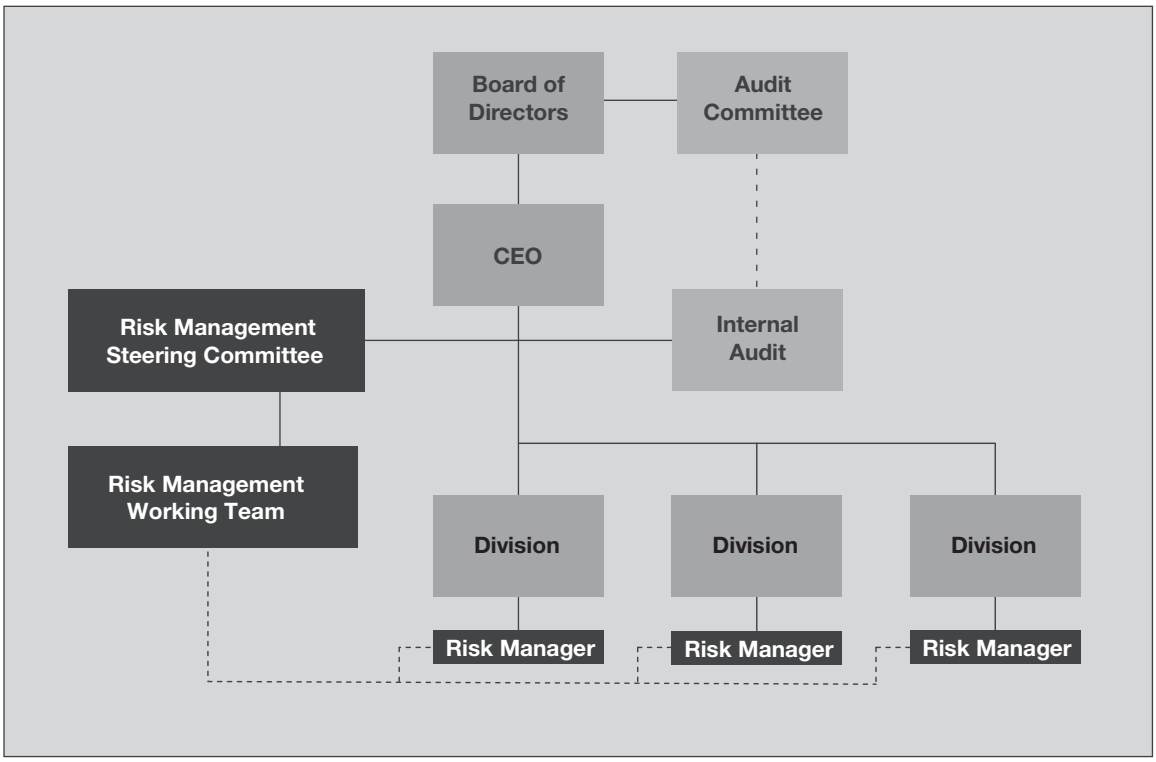


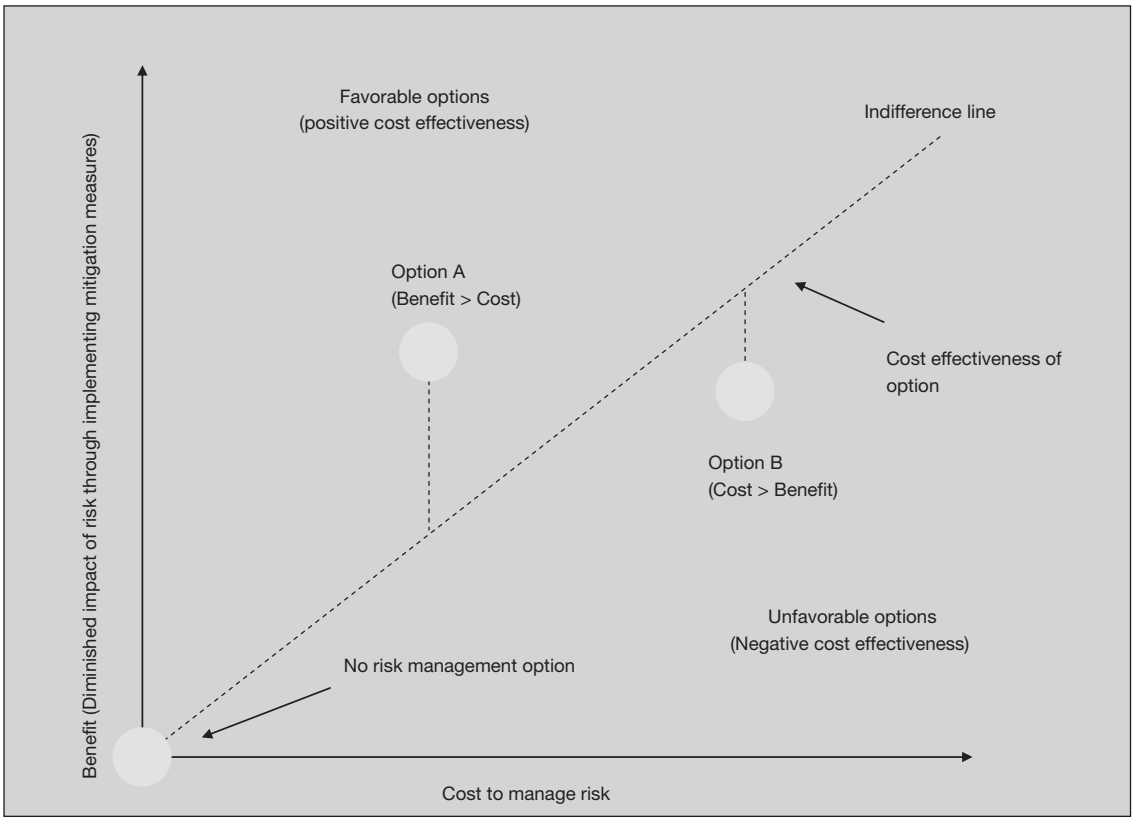

**Illustration 5.3: Examples of Risk**

| Market | Financial | Operational | Compliance | Force Majeure |
|---|---|---|---|---|
| • Customer demand<br>• Competitor actions<br>• Brand and product image<br>• Technology<br>• Economic growth<br>• Commodity prices<br>• Reliance on key customers | • Access to capital<br>• Financial leverage<br>• Interest rate volatility<br>• Accounting systems<br>• Customer credit<br>• Foreign exchange volatility<br>• Changes in investment | • Access to resources<br>• Quality assurance<br>• Project management<br>• Performance of vendors & subcontractors<br>• Client expectation<br>• Product design management<br>• Production capacity planning | • Regulatory changes<br>• Breach of law and regulations<br>• Non-compliance to standard procedures | • Natural events, including natural disasters that profoundly affect a company's operations, suppliers, or customers. |

**Illustration 5.4: Risk Ranking Table**

| Risk Ranking Table | | | |
|---|---|---|---|
| | | **Impact** | **Vulnerability** |
| 1 | Risk 1 (Frequent delay in production) | High | High |
| 2 | Risk 2 (Poor product quality) | High | Low |
| 3 | Risk 3 (Untimely and inaccurate financial reporting) | Low | High |
| 4 | Risk 4 (High staff turnover) | Low | Low |

**Illustration 5.5: Cost Effectiveness Analysis**



### Tools 5.6: An Executive Diagnostic

Establishing clearly defined risk management objectives and identifying and assessing the risks that pose a danger to your company are key steps toward managing business risk. The following 20 questions will help you evaluate your risk management process.

| | | Yes | Somewhat | No |
|---|---|---|---|---|
| ***Plan the risk management effort*** | | | | |
| 1 | Do you view risk management as a process to formally assess the aggregate impact of a risk across all areas of the organization? | | | |
| 2 | Does your risk management process extend beyond protecting existing assets to anticipating and addressing risk identified during your strategic planning process? | | | |
| 3 | Do you currently have a clearly articulated set of risk/return objectives that communicate priorities, parameters, and accepted practices to guide decision-making? | | | |
| 4 | Is your board of directors actively involved in the determination and eventual approval of your company's risk tolerance? | | | |
| 5 | Do you have a risk management steering committee or similar senior management body that functions as the visible sponsor of the risk management initiative? | | | |
| 6 | Has your company developed and implemented processes and structures designed to establish the requisite risk management culture enterprise-wide? | | | |
| ***Identify and assess the risk*** | | | | |
| 7 | Do you have a well-structured, systematic process for identifying risk? | | | |
| 8 | Does your risk identification process solicit input from all areas (e.g., functional, geographical, product lines) and levels of the organization? | | | |
| 9 | Is your risk identification process aligned with your company's strategic plans? | | | |
| 10 | Do you evaluate the potential significance of risk to your company? | | | |
| 11 | Does your company attempt to quantify the potential impact of a risk? | | | |

| | | Yes | Somewhat | No |
|---|---|---|---|---|
| 12 | Does your company maintain a database of historical data upon which it draws to assess key risks? | | | |
| 13 | Does your organization systematically compare the potential impact of various risks to ensure that resources are allocated appropriately? | | | |
| ***Manage the risk*** | | | | |
| 14 | Does your company develop several different sets of actions or risk management options? | | | |
| 15 | To develop risk management options for each risk, does your company seek ways to modify its operations, employ financial instruments, and implement control systems? | | | |
| 16 | For each risk management option, does your company quantitatively assess both the cost to implement the option and its expected benefit? | | | |
| 17 | When evaluating risk management options, does your company consider the cost effectiveness of two options in combination as compared with the effectiveness of the two individually? | | | |
| 18 | Is your company's risk management process aligned with the budgeting process to ensure that human, financial, and other resources are appropriately allocated? | | | |
| 19 | Does your company have a review and monitoring process to ensure that the organization's risk management objectives are being achieved? | | | |
| 20 | When assessing the performance of your company's risk management process, do you examine its flexibility to adapt to recent changes in the external environment? | | | |

*If more than 75% of your answers (16 of 20) are "Yes," then your company is addressing the challenges of managing organizational risks. If 50 to 75% of your answers (10 to 15) are "Yes" or "Somewhat," there is more work to be done in order to effectively manage risk. If less than 50% of your answers are either "Yes" or "Somewhat," your company needs to re-evaluate its approach towards managing business risks.*

| | | |
|---|---|---|
| ***Re-evaluate →*** ***0 - 49% →*** | ***→ Needs more work →*** ***→ 50 - 75% →*** | ***→ Ready*** ***→ 76 - 100%*** |

## 6. Further Readings

- "The risk intelligent enterprise: ERM done right." Deloitte Publications. http://www.deloitte.com/dtt/research/0,1015,sid%253D118358%2526cid%253D145923,00.html

- "The risk intelligent chief audit executive: Mission possible." Deloitte Publications. http://www.deloitte.com/dtt/research/0,1015,cid%253D169187,00.html

- "Disarming the value killers: A risk management study." Deloitte Publications. http://www.deloitte.com/dtt/research/0,1015,cid%253D169188,00.html

The Hong Kong Institute of Directors

Corporate Governance Toolkit

# Understand Basic Internal Controls

Reference and page number in “Guidelines on corporate Governance for SMEs in Hong Kong”

| **Reference number** | **Page** | **Title → subtitle in Guidelines** |
|---|---|---|
| 4.7 | 53 | Management Practice Guidelines → Controlling |

Management practice cycle (“Guidelines on corporate Governance for SMEs in Hong Kong” page 8)

| **Cycle Number** | **Management practice cycle** |
|---|---|
| 1 | Planning |
| 3 | Operations/Implementation |
| 6 | Controlling |

## 1. Overview

Internal control is a broad concept that means different things to different people, for example, a web engine search will give you over 12 million results. A more popular definition is the one given by The Committee of Sponsoring Organizations of the Treadway Committee ("COSO Framework"), which defines internal control as:

***"a process designed to provide reasonable assurance regarding the achievement of business objectives."***

Another definition is the one below, found in the Hong Kong Standard on Auditing ("HKSA") 315-Understanding the Entity and its Environment and Assessing the Risk of Material Misstatement, issued by The Hong Kong Institute of Certified Public Accountants, which defines internal control as:

***"the process designed and effected by those charged with governance management, and other personnel to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. It follows that internal control is designed and implemented to address identified business risks that threaten the achievement of any of these objectives."***

In general, internal controls are regarded as the policies and procedures established in a company to provide reasonable assurance to achieve:

- **"Reliability of financial reporting"**, which relates to the preparation of reliable published financial statements, including company level and consolidated financial statements and selected financial data derived from statements such as earnings releases, business segment information, etc.

- **"Effectiveness and efficiency of operations"**, which addresses an entity's basic business objectives, including performance and profitability goals and safeguarding of assets.

- **"Compliance with applicable laws and regulations"**, which deals with complying with those laws and regulations which an entity is subject to.

In order to achieve these objectives, management must understand all the elements of the internal control system. The COSO Framework is a well-known concept that depicts internal controls as a combination of the following five components:

- **Control environment:** The control environment is regarded as the "tone at the top" of a company, influencing the control consciousness of its people. It is a fundamental element of the internal control system as it determines an organization's attitudes, culture & values, the integrity of management and their commitment to the entity's internal control. Control environment factors include integrity and ethical values of management and employees; a commitment to competence; the management's philosophy and operating style; assignment of authority and responsibility by management; development of organization structure; and the attention and direction provided by the board of directors and committees.

- **Risk assessment:** Understanding your entity and the business environment it faces are keys to success and the achievement of business objectives. A risk assessment is an exercise that prompts management to think ahead about the risk that they are facing internally (e.g. loss of copyrights, narrow customer base, financial distress and etc.) and externally (e.g. changes in laws and regulations, economy outlook and political stability, etc). A Risk assessment can be seen as a process that helps to identify and analyze the relevant risks that affect the achievement of an entities objectives, and as a means of forming a basis to determine how these risks should be managed.

- **Control activities:** Control activities are policies and procedures established by management to ensure that necessary actions are taken to address risks which affect the achievement of an entity's objectives. Control activities are established and performed throughout the organization, at all levels and in all functions. They include a wide range of activities, such as approvals, reconciliations, management reviews, segregation of duties, and safeguarding of assets, etc.

- **Information and communication:** Effective information and communication requires that relevant external and internal information be identified, captured, processed, and communicated throughout the organization in a timely manner. Effective communication must also occur in a broader sense, flowing up, down, and across the organization. From the internal perspective, management expectations should be clearly communicated to employees so that they are fully aware of their roles and responsibilities within the internal control system. On the other hand, effective communication with external parties, such as customers, suppliers, regulators and shareholders should also be maintained.

- **Monitoring:** Monitoring is the process by which an entity continuously assess the strength of its internal control system. This on-going exercise can be carried out by management itself or by external parties. Monitoring includes an evaluation of the design of controls to ensure that they are in place to mitigate high risk areas and the operating effectiveness of controls to ensure that they are properly running and adhered by the responsible staff. The monitoring component of internal controls should include a mechanism for reporting internal control deficiencies and taking appropriate action. If internal control deficiencies are identified during the assessment, management should consider any compensating controls that may be in place to mitigate the same risk or they should remediate the existing controls.

These components are derived from the way management runs a business, and are integrated into the business processes. Although the framework can be applied to all companies, how it constitutes into a company varies depending on the size and complexity of the company in question. Usually, internal controls systems in smaller companies tend to be less formal than those in larger companies. These five components are not stand-alone but closely integrated with each other. One important thing to bear in mind is to understand how these components relate to each other.

## 2. What You Can Do

### 2.1. Level of internal controls

When establishing an internal controls system, management should understand that there are three levels of controls that exist within a company:

- **Corporate-level controls:** This level of controls is designed and implemented at the corporate level and relates to the "tone at the top". Controls at this level create the control awareness of the whole company and have a pervasive effect on all business processes. The implementation of corporate-level control is usually the responsibility of the Company's management and examples of controls at this level include:
    - The development of a code of conduct and other policies regarding acceptable business practices, conflicts of interest, and expected standards of ethical behaviour;
    - Clearly defined organization structures and reporting lines;
    - The development of clear job descriptions in order to facilitate understanding of roles and responsibilities of management and employees;
    - Monitoring of the company's operations and performance by senior management and the board of directors through regular meetings;
    - The establishment of a whistle-blower program; and
    - The establishment of an internal audit function and regular internal controls reviews.
- **Controls over financial closing and reporting:** This level of controls can provide reasonable assurance that the financial information pertaining to a company is valid, accurate and complete. Examples of controls as this level include:
    - The development of accounting policies that clearly state the accounting treatment of different types of transactions;
    - The development of financial closing and reporting policies and procedures that govern the financial closing and reporting process;
    - Reconciliation of key accounts, such as bank and cash accounts, accounts receivable and accounts payables;
    - Review and approval of journal entries;
    - Maintenance of chart of accounts and trial balance groupings;
    - Establishment and regular monitoring of a budget; and
    - Segregation of duties with regards to the preparation, approval and posting of journal entries.
- **Business-level controls:** This level of control applies to all departments and functions of a company and should exist in all business processes. Examples of controls at this level include:
    - The development of policies and procedures to govern key business processes;

- The establishment of suppliers selection criteria and performance of competitive bidding before the engagement of suppliers;
- Independent review and approval of purchase orders before purchase is made;
- Conducting background checks and assigning credit limits to customers;
- Review of performance report by management;
- Conducting quality controls and inspections before the shipment of goods;
- Implementation of security controls at warehouses and office premises;
- Assigning system access rights in accordance with job duties;
- Maintaining evidence of performance of controls; and
- Segregation of duties between incompatible responsibilities, such as initiation, review and approval of transactions.

### 2.2. Types of internal controls

Factors such as adequacy of people, processes and technology within an entity should be considered when designing the type of control activities to be implemented. Typically, internal control activities can be categorized into the following types:

- **Preventive controls:** Preventive controls are designed to prevent an error or misappropriation from occurring. They are mean to be 'before-the-fact' controls that will prevent a transaction from being processed. Preventive controls are considered less costly in the long run and more beneficial than detective controls since they "prevent" the problems from happening in the first place. Examples of preventive controls include:
  - The segregation of duties to prevent concealment of fraud; and
  - The control of access rights within information systems to prevent unauthorized access to the company's information.
- **Detective controls:** Detective controls are designed to detect errors. Examples of detective controls include:
  - Accounts reconciliation to detect the accuracy, completeness and cut-off of recording; and
  - Review of exception reports to detect possible errors.

- **Corrective controls:** Corrective controls are designed to correct errors or irregularities that have been detected. Examples of corrective controls include:
    - Cleaning out a virus from an infected system; and
    - A guard checking and locking a door left unlocked by a careless employee.
- **Manual controls:** Manual controls are performed manually. Examples of manual controls include:
    - Management reviewing and physically signing on the sales invoice as evidence of approval; and
    - Accounting personnel conducting an inventory count in a warehouse.
- **Automated controls:** Automated controls are performed or built into information systems. Examples of automated controls include:
    - Input control performed by an information system to ensure the accuracy of data input; and
    - Regular anti-virus scanning performed by an information system to prevent and detect virus intrusion.

When establishing or enhancing an internal controls system, management should first identify the objectives of the control at both the corporate and business-process level and conduct an initial review of its existing organizational structure and operations to identify the possible internal controls design flaws and operating weaknesses. Management should develop action plans to remediate any flaws and weaknesses identified and also consider establishing, or refining policies and procedures governing the daily operations of key business processes. Regular internal controls reviews should also be conducted to assess the operating effectiveness of existing controls and the needs of re-designing internal controls due to changes in circumstances.

For a preliminary diagnostic of your company's internal control system, please refer to Tools 4.1 for detail.

## 3. Benefits/Limitations

**3.1. Benefits.** An effective internal controls system is a basic component of corporate governance and can enhance a company's efforts to mitigate its risks and achieve its business objectives. The existence of internal controls provides guidance to employees to perform their jobs in accordance with management's intentions and assists them in detecting errors in a timely manner, which can ultimately save time and money. In addition, internal controls act as a deterrent for those considering fraud and non-compliance with relevant laws and regulations.

**3.2. Limitations.** Internal controls, no matter how well designed and operated, can only provide reasonable assurance with regards to achieving the company's objectives. An internal controls system can be circumvented by human factors, such as errors or mistakes, management overrides and collusion between two or more people to commit fraud. In addition, the current system in place, may not be able to process some non-routine or irregular transactions. Such transactions may be more likely to be misclassified accidentally or deliberately, in order to process the transaction. The establishment and maintenance of an effective internal control system can be costly, and is an on-going process. Management should balance the costs and benefits of the scope of the system and allocate resources to high risk areas.

## 4. Tools, Templates and Illustrations

### Tools 4.1: Internal Controls Diagnostic Survey

This Internal Controls Diagnostic Survey is designed to preliminarily assess the company's internal controls environment, system and procedures. This survey is mainly for privately held Small and Medium Enterprises. The survey is developed based on the Code of Corporate Governance issued by the Stock Exchange of Hong Kong and also includes many of the important concepts in the COSO internal control framework, including management's commitment to effective internal control, the identification of controls to mitigate financial reporting and disclosure risk, and independent monitoring of the internal control program.

For each of the following statements, select a "Yes" or "No" to indicate whether or not the company currently employs the related control in an effective manner. If a particular control is not applicable to the organization, put "N/A" and explanations under the remarks column.

| | | Yes | No | Remarks |
|---|---|---|---|---|
| **(I)** | **Integrity and Ethical Value** | | | |
| | Documented ethical policies/guidelines (e.g. code of conduct, conflict of interest policy, staff handbook, etc.) are established and communicated to the employees. | | | |
| | Procedures and records for employee's sign-off for acknowledgement of contents in the code of conduct, conflict of interest policy, staff handbook, etc. | | | |
| | Staff orientation or general meeting covers the company's integrity and ethical value. | | | |
| **(II)** | **Board of Directors** | | | |
| | Board of Directors are established and periodically reviews the internal controls over financial reporting. | | | |
| | Board of Director holds regular meetings to discuss the internal controls issues. Minutes of board meetings are kept. | | | |
| | The Board is composed of at least 3 independent non-executive directors, and one of which should have the appropriate professional qualifications or accounting or related financial management expertise. | | | |

| | | Yes | No | Remarks |
|---|---|---|---|---|
| **(III)** | **Internal Audit Function** | | | |
| | Audit Committee is established. | | | |
| | The audit committee is composed of at least two members who are independent non-executive directors. At least one member of audit committee has recent and relevant financial experience. | | | |
| | Internal audit function is established to review the internal control effectiveness. | | | |
| | Internal control review plans are developed and approved by the senior management or audit committee (if any). | | | |
| | Internal audit findings are communicated to the management. Management responses are provided and proper follow-up actions are taken. | | | |
| **(IV)** | **Assignment of Authority and Responsibility** | | | |
| | Job descriptions, roles and authorities, especially for key positions, are clearly defined and documented. | | | |
| | Organization structure, roles and responsibilities and reporting lines of each business unit/division are clearly defined and documented (e.g. organization chart, etc.). | | | |
| | Authorization and approval of transactions are assigned and documented in company policies. | | | |
| | Proper segregation of duties is maintained among the board of directors, finance executives and audit committee members (if any). | | | |
| **(V)** | **Financial Reporting Controls** | | | |
| | All period-end adjustment journals are supported by adequate information and approved by the management. | | | |
| | Related-party transactions are identified during the period-end process | | | |
| | Financial reports are analyzed and its results are reviewed by Senior Management (including Board of Director). | | | |

| | | Yes | No | Remarks |
|---|---|---|---|---|
| **(VI)** | **General Computer Controls** | | | |
| | Financial systems are secured with password protection. | | | |
| | All financial data (including analysis spreadsheet) are backed up regularly. | | | |
| | Computer server room are secured with limited access and with fire-proof equipment. | | | |
| | Disaster recovery plan & business continuity plan are developed and tested. | | | |
| **(VII)** | **General Policy & Procedures** | | | |
| | Accounting policies and procedures, financial closing procedures, reporting & disclosure procedures and budgeting policies are established, including:<br>– capturing and processing routine and non-routine information by central finance function<br>– preparing financial statements in accordance with applicable accounting standards<br>– reviewing and approving financial statements and reports<br>– dealing with errors and deficiencies in financial reporting<br>– budget variance analysis | | | |
| | Human resources policies and practices are established, especially including:<br>– staff recruitment and selection criteria<br>– departure of management and supervisory personnel evaluation<br>– performance evaluation<br>– continuous training<br>– compensation structures<br>– disciplinary actions | | | |
| | Procedures on evaluation of potential investments/ventures are established. | | | |
| | Policies and procedures of various business processes and operations are established. | | | |

## 5. Further Readings/References


- "Lean and balanced: How to cut costs without compromising Compliance." Deloitte Publications. http://www.deloitte.com/dtt/research/0,1015,sid%253D7108%2526cid%253D158271,00.html

- "Quality assessment-achieving greater enterprise value and Better corporate governance through effective internal audit performance." Deloitte Publications. http://www.deloitte.com/dtt/article/0,1002,cid%253D169183,00.html

# The Hong Kong Institute of Directors

# Corporate Governance Toolkit

# Develop Policies and Procedures

Reference and page number in “Guidelines on corporate Governance for SMEs in Hong Kong”

| **Reference number** | **Page** | **Title → subtitle in Guidelines** |
|---|---|---|
| 2.1.7 | 15 | What governance practices do Hong Kong SMEs need? → The need for good governance |
| 2.3.3 (b) | 21 | What governance practices do Hong Kong SMEs need? → Category 2 |
| 2.4.3 (d) | 24 | What governance practices do Hong Kong SMEs need? → Category 3 |

Management practice cycle (“Guidelines on corporate Governance for SMEs in Hong Kong” page 8)

| **Cycle Number** | **Management practice cycle** |
|---|---|
| 1 | Planning |
| 3 | Operations/Implementation |
| 6 | Controlling |

# 1. Overview

A policy is a written statement that clearly indicates the position and values of the organization on a given subject/area. It contains rules and tells one what to do. A procedure is a written set of instructions that describe the approval and recommended steps for a particular act or sequence of acts. It tells one how to perform a set of tasks.

Policies and Procedures are a set of documents that govern an organization's operational processes. It is a fundamental element of the corporate governance structure that describes the objectives and procedures which align with management's intention. Policies and procedures need to be carefully designed to strike an even balance between control and flexibility in order to meet ever changing business dynamics. The specifics of any set of policies and procedures should be unique to an organization's business objectives and operating needs and should address issues that arise regularly in business operations.

# 2. What You Can Do

## 2.1. Develop policies and procedures

Policies and procedures development involves identifying needs, gathering information, drafting, consulting and review. The following steps summarize the key stages involved in policies and procedures development:

- **Identify needs:** The organization needs to constantly assess its activities, responsibilities and the external environment in order to identify the need for policies and procedures in various areas of operation.

- **Identify who will take lead responsibility:** The organization needs to delegate responsibility to an individual working group, sub-committee or staff members, according to the expertise required.

- **Gather information:** Before drafting a policy, the organization needs to

    - obtain background information in the areas to be addressed

    - understand information about legal responsibilities in the areas;

    - identify the best and practical practices in handling the issues and relevant templates or examples for reference;

    - identify the source of the guidance (if any)

- **Draft policy:** During the process of drafting the policy, the organization has to ensure that the wording, length and complexity of the policy is appropriate to those who will be expected to implement it.

- **Consult with appropriate stakeholders:** Policies are most effective if those affected are consulted, are supportive, and have the opportunity to consider and discuss the potential implications of the policy. Therefore, the organizations should consult with appropriate stakeholders, such as supporters, staff, service users or beneficiaries, the management and/or the Board of Directors.

- **Finalize/approve policy:** To get the policy finalized, the draft policy should be reviewed and approved by management. If the policy relates to strategic issues, it should be approved by the Board of Directors of the organization. Bear in mind that ultimately the Board of Directors is responsible for all policies and procedures within the organization.

- **Consider whether procedures are required:** Procedures are required to support internal policies. The organization needs to consider whether there is a need for clear guidance regarding how the policy will be implemented and by whom. If so, then, it needs to determine who will be responsible for developing these procedures, timeline for the same, and what will be the processes for consultation, approval and implementation.

- **Implement:** To make sure that the policies and procedures are implemented effectively, effective communication of the policies and procedures to the related parties is very important. Effective communication tools include internal announcement, policies and procedures distribution, training, or even press release for external policies.

- **Monitor, review and revise:** The monitoring and reporting systems should be developed and put in place to ensure that the policy is implemented and to assess usage and responses. Policies and procedure should also be periodically reviewed (i.e. annually) and updated (if necessary) in order to address the latest needs of the organization.

### 2.2. Key components of policies and procedures

The followings are the key components of most policies and procedures documentation. It is intended to highlight things you need to be aware of when drafting policies and procedures.

- **Title** – All policy and procedure documents should be clearly titled and dated to help ensure users are using the correct policy and version.

- **Purpose** – The objectives of the policy should be clearly and concisely stated. The purpose statement is meant to help users understand the objectives of the policies and procedures that are trying to achieve. The purpose statement should also help users understand how the policy will help achieve the goal(s) and objective(s) of not only the department/business function but the company as well.

- **Scope** – A description of the breadth and width to which the policy and procedures will be applicable should be included. The scope will help users understand when and where the policies and procedures are applicable.

- **Roles and Responsibilities** – Roles and responsibilities of key departmental positions should be identified and documented in the policies and procedures. Each department/business function will have its own composition of positions with unique roles and responsibilities. Documenting the roles and responsibilities of key positions will help highlight segregation of duty conflicts. Where segregation of duty conflicts are noted, they should be addressed and resolved before the policy is issued.

When drafting the roles and responsibilities section of the policies and procedures document, you should also evaluate the authority levels of their staff. Authority levels not only refer to monetary thresholds of approval but also the use of professional judgment. No matter how sound the policies and procedures are, they may not cover every possible situation. Clearly defining roles and responsibilities facilitates decision making when professional judgment needs to be exercised at the time the policy is not applicable. Also, it enhances the ownership and accountability of the person assigned.

- **Frequently Asked Questions (FAQ)** – An additional section that may be considered is an FAQ section. Most procedural documentation will address what needs to be done but what happens when things go wrong. An FAQ section is a compilation of commonly asked questions that can help address common misconceptions or misunderstandings.

- **Revision History** To ensure procedural documentation reflects actual practice, policies and procedures should be reviewed and updated regularly. The revisions should be tracked via a revision history. A revision history will allow the document owner to maintain version control and track when existing policies and procedures are outdated.

- **Appendices** – Appendices may be used to provide supplementary information. Some suggested appendices are as follows:

    - Sample Documents – Current standard documents may be included in the appendices for easy reference.

    - Responsibility Matrix – A responsibility matrix is used to map the responsibility to duties that need to be segregated. This section should be consistent with the Roles and Responsibilities section.

### 2.3. Things for Consideration

A policy is not a standalone document. It must be considered alongside all the policies of the organization. The policy should be designed with the goal(s) and objective(s) of the department/ business function, which in turn, should be aligned with the goal(s) and objective(s) of the organization as a whole.

Each policy must be formulated with careful thought. Do not simply draft a policy simply because it is required. Policies carelessly drafted will not only hinder your ability to meet organization goal(s) and objective(s) but also assign accountability which is out of management control. Some points that should be considered while drafting your policy are as follows:

- **Flexibility.** Due consideration should be placed in determining the restrictiveness of the policy. You should always remember that a policy is meant to be a guidance tool but not meant to tie the hands of management or their supporting staff. The question therefore should be how much guidance is need? In order to answer this question, you should consider the operations to which the policy is applied. Dynamic operations that are constantly changing tend to have a more flexible policy whereas operations under penalty of laws and regulations (e.g. financial institutions) will use a more restrictive set of policies and procedures.

- **Language.** The wording of the policy should be user-friendly and understandable to any user. That is not to say industry/operation specific terminology should not be used. On the contrary, when industry/operation specific jargon is used, they should be explained. Considering the internal consistency of industry/operation specific jargon, policies should avoid using different words that mean the same thing. It will cause confusion and ambiguity which will impair the usability of the policy. An effective set of policies and procedures manual may serve as a training manual for new staff.

- **Cost.** Policy makers should assess the costs and benefits of the policies set. If implementing a policy will cost a firm more (in the form of inefficiencies, additional resources, compliance monitoring, etc.) than the benefits it will provide (i.e. reduced uncertainty, consistent performance, reduced supervision, etc.) then the policy needs to be tweaked.

## 3. Benefits/Limitations

**3.1. Benefits.** Clearly stated corporate policies and procedures are significant documents that guide and support efficient operation of an organization. In addition, comprehensive written policies or procedures advocate consistent performance standard among employees. Furthermore, policies or procedures that are available to outsiders such as government offices, suppliers and regulation agencies could help a company promote its corporate culture and reputation.

**3.2. Limitations.** Policies and procedures are costly to maintain and monitor. Management should assess the cost and benefit of the policies before implementation. Rigid policies, sometimes, may hinder the flexibility of business operations and the efficiency of decision making.

## 4. Tools, Templates and Illustrations

### Illustration 4.1: Sample Policies and Procedures

**The Expenditure Cycle Vendor Selection – (3.2.1.)**

**Section A – Purchasing Manual, Policies and Procedures**

| | |
|---|---|
| SOP no. | 3.2.1. |
| Version: | 1.0 |
| Revision Date: | |
| Effective Date: | dd.mm.yyyy to dd.mm.yyyy |
| Subject: | Vendor Selection |

**Section B – Policy:**

The procedures specified in the following document have been developed to align the internal controls of the purchasing department with the Company's business objectives and ensure due care is taken in selecting new vendors and new sources of supplies.

All selected vendors should meet the selection criteria, approval requirements, documentation standards and monitoring and inspection procedures laid out in the following procedures.

For clarification and/or interpretation, refer to your employee handbook or the Purchasing Manager.

**Section C – Purpose:**

To provide a framework and guidance for evaluating, documenting and inspecting vendors that is compliant with the policies and business objectives of the Company.

To identify sources of high quality and value raw material and/or services for the Company.

**Section D – Scope:**

This document is applicable to any vendors, potential or otherwise, of products, materials, and services that are used directly in the delivery of the Company's goods and services to its customers.

**Section E – Roles and Responsibilities:**

Purchasing Manager:

[A description of the Purchasing Manager's role and responsibilities (or a position of like duties) should be outlined – This section may be centralized in the Purchasing Manual or referenced to the appropriate material (i.e. HR documents)]

Buyer:

[A description of Buyer's role and responsibilities (or a position of like duties) should be outlined – This section may be centralized in the Purchasing Manual or referenced to the appropriate material.]

Purchasing Clerk

[A description of Purchasing Clerk's role and responsibilities should be outlined – This section may be centralized in the Purchasing Manual or referenced to the appropriate material.]

**Section F – Procedures:**

**1. Vendor Selection Criteria**

[Vendor selection criteria should be identified and guidance on selecting a new vendor should be provided. The criteria are meant to provide a consistent framework for evaluating new vendors and improve the comparability between different vendors. Multiple factors should be considered for a more comprehensive evaluation and the factors should reinforce the business objectives of the company.]

Before any vendor is accepted, the following criteria must be reviewed and evaluated. Only satisfactory vendors will be accepted. The evaluation vendor selection criteria are as follows:

- **Pricing:** Pricing refers to the purchase price charged by the vendor in exchange for delivery of goods and/or services. Pricing is only one component of value and must be considered along side with the other selection criteria.

- **Quality (product or service):** Quality refers to the quality of the goods and/or services delivered. The number of defects per order can cause costly operating disruption. Companies with ISO certification or other relevant documentation (i.e. SAS reports) should be obtained and reviewed.

- **Delivery:** Delivery refers to the turn around time from the moment the order is placed till the goods and/or services have been received. Extensions on turn around time can cause operating disruptions.

- **Capacity/Availability:** Capacity refers to the size of the order the vendor can deliver. Availability refers to the ability of the potential vendor to deliver the requested service within a defined timeframe.

- **Financial Metrics:** Financial metrics refers to the financial health of the vendor. The financial health of the vendor can expose the company to unnecessary supply chain risks.

- **Post-purchase service:** Post-purchase services refer to the support or service after the goods or services have been provided. Significant post-purchase services can help avoid potential costly operating disruptions.

All selection criteria must be evaluated and an appropriate balance between the different criteria must be achieved.

## 2. Monitoring Selected Vendors

Guidelines for monitoring existing vendors should be provided. The guidelines should stipulate when and how regular reviews of existing vendors should take place and the evaluation criteria. For noted exceptions, they should be investigated and resolved. Regular monitoring of selected vendors will help maintain a consistent level of vendor service and help identify problematic vendors.

Selected vendors will be re-evaluated at least annually by the Purchasing Manager based on the following criteria:

- **Delivery:** Vendors that have an on-time delivery rate below X% will be subject to investigation. The treatment for vendors with an on-time delivery rate below X% is at the Purchasing Manager's discretion, however, the decision must be fully documented in an Annual Evaluation Exceptions report and retained in the hard copy vendor files.

$$\text{On-time delivery rate} = \frac{\text{Total number on-time deliveries per vendor}}{\text{Total number of deliveries received per vendor}} \times 100\%$$

- **Quality (product or service):** Vendors that have a defect percentage above X% will be subject to investigation. The treatment for vendors with a defect percentage above X% is at the Purchasing Manager's discretion, however, the decision must be fully documented in an Annual Evaluation Exceptions report and retained in the hard copy vendor files.

$$\text{Defect percentage} = \frac{\text{Total number of rejected items per vendor}}{\text{Total number items received per vendor}} \times 100\%$$

- **Financial Metrics:** If possible, the financial performance of each supplier should be reviewed to alert management of any of potential disruptions in operations. The treatment for vendors with signs of financial distress is at the Purchasing Manager's discretion, however, the decision must be fully documented in an Annual Evaluation Exceptions report and retained in the hard copy vendor files.

## 3. Conflicts of Interests

Conflicts of interests, perceived or in actuality, should be defined and appropriate mitigating measures should be included. Conflicts of interests are a potential cause for unethical behaviour and represent a potential fraud risk to the organization. This section of the policy should be tied to the Company's Code of Conduct and/or Ethical Guidelines.

As defined on page X of the Ethical Guidelines, a Conflict of Interest is defined as any situation in which an individual holds a position of trust and is in a position to influence the outcome of an event for their personal gain, monetary or in-kind, at the expense of the Company, monetary or in-kind.

All conflicts of interest must be disclosed annually through the annual disclosure outlined in the Ethical Guidelines on page X. Disclosure must be made to the immediate supervisor if a conflict of interest arises in between disclosure periods and must be disclosed in the following annual disclosure.

## 4. Vendor Set Up Procedures

The procedures for the set up of new vendor data in the supplier master file should be documented. Procedural documentation will help maintain consistent performance levels and help highlight potential internal control weaknesses. It also has the added benefit of facilitating knowledge transfer to new employees.

Procedural Documentation should be considered as a living document and must be updated regularly as procedures change to be effective.

4.1. Vendor Set Up Procedures

4.1.1. All vendors that have been set to "inactive" status or have had no prior transactions with the Company must be approved by the Purchasing Manager before they are accepted.

4.1.2. Once a suitable vendor has been identified by the Buyer, the Buyer will complete a Vendor Evaluation and Acceptance form and submit it to the Purchasing Manager, along with any other supporting documentation (i.e. credit reports, ISO certifications, etc.) for approval.

4.1.3. Using the selection criteria outlined in 1.0 Vendor Selection Criteria, the Purchasing Manager shall evaluate the new potential vendor and assess whether the vendor is acceptable.

4.1.4. If the vendor is acceptable, the Purchasing Manager shall sign the Vendor Evaluation and Acceptance form as evidence of approval and forward signed Vendor Evaluation and Acceptance form to the Buyer who will complete a Supplier Master File Change Request form.

4.1.5. The completed Supplier Master File Change Request form and signed Vendor Evaluation and Acceptance form are sent to the Purchasing Clerk for entry in to the Supplier Master File.

[Note: Screenshots illustrating entry would be useful.]

4.1.6. The Purchasing Clerk shall verify all Vendor Master File Change Request forms to be processed have been approved by the Purchasing Manager or are supported with a Supplier Master Change Request form signed by the Purchasing Manager.

4.1.7. At month end, the Purchasing Manager shall review a system-generated change report generated from the Supplier Master File. All exceptions shall be investigated and resolved. The system-generated change report shall be signed by the Purchasing Manager.

Other procedural sections that should be included are listed in the following

4.2 Change in Vendor Data Procedures

4.2 Inactive Vendor Data Procedures

4.2 Others [Other applicable sections may be added]

**5. Vendor Files**

The procedures for maintaining vendor files should be included. Vendor files should be retained to allow for an audit trail and serve as evidence for decisions made. The company's documentation standards should be reflected in this section and referenced if necessary. The documents to be retained, the retention method and retention period should also be included.

A vendor file should be prepared and maintained for each approved vendor of the Company. The vendor file will be retained on-site for a period no less than X years and will contain, but not be limited to, the following documents:

- Vendor Evaluation and Acceptance Form – From the initial evaluation and acceptance of the vendor
- Annual Evaluation Exceptions Report (if applicable) – From the annual monitoring of selected vendors
- Supplier Master File Change Request Forms – From the initial request for setup of the vendor in the supplier and subsequent vendor information changes (if applicable)
- Other supporting documentation

The vendor file should be maintained for all active vendors and for no less than an additional X years after the active vendors become inactive.

**Section G- Revision History**

| Version | Issue Date | Next Scheduled Review | Description of Change |
|---|---|---|---|
| 1.0 | dd.mm.yyyy | dd.mm.yyyy | Original Document |
| | | | |
| | | | |

**Template 4.2: Policies and Procedures Templates**

**Sample Procedures Template**

The following template contains information that should be included in your procedures.

| **Procedure Template** | |
|---|---|
| Document Number: | Date: |
| | Revision Number: |
| Description: | |
| This procedure involves… The activity's primary aim is to... | |
| Entry Criteria/Inputs: | Exit Criteria/Outputs: |
| Roles:<br><br>Role Name: What does she/he do? | |
| Assets:<br><br>Standards, reference material, deliverables, previous process descriptions… | |
| Summary of Tasks (List major tasks/process steps):<br>Task 1<br>Task 2<br>Task 3<br>Task 4 | |
| PROCEDURE STEPS | |
| Task 1<br>• Detail Step 1<br>• Detail Step 2<br>• Detail Step 3<br>• Detail Step 4 | |
| Task 2<br>• Detail Step 1<br>• Detail Step 2<br>• Detail Step 3<br>• Detail Step 4 | |
| Continue… | |

**Sample Policies Template**

The following information can be used to structure your policies.

**Requirements Management (RM) Policy**

**1.0 Purpose**

- Manage the requirements of the project's products and product components
- Identify inconsistencies between those requirements and the project's plans and work products.

This policy applies to software projects within the xxx Division of the xxx organization. The term "project," as used in this policy, includes system and software engineering, maintenance, conversion, enhancements, and procurement projects.

**2.0 Scope**

**3.0 Responsibilities**

- The project manager shall ensure that the RM process is followed.
- Each project will follow a process that ensures that requirements will be documented, managed, and traced.

**4.0 Verification**

RM activities will be reviewed with higher-level management, and the process will be objectively evaluated for adherence by the Quality Assurance (QA) staff.

**5.0 Sign-offs**

The following shall review and approve this policy:

- Associate Director
- Quality Assurance
- EPG Chairman

## 5. Further Readings/References

- Stephen Page. "Establishing a System of Policies and Procedures." 2002.
- Stephen Page. "Best Practices in Policies and Procedures." 2002.

# The Hong Kong Institute of Directors

# Corporate Governance Toolkit

# Develop Code of Conduct

Reference and page number in “Guidelines on corporate Governance for SMEs in Hong Kong”

| **Reference number** | **Page** | **Title → subtitle in Guidelines** |
|---|---|---|
| 2.5.28 | 34 | What governance practices do Hong Kong SMEs need? → Category 4 |

Management practice cycle (“Guidelines on corporate Governance for SMEs in Hong Kong” page 8)

| **Cycle Number** | **Management practice cycle** |
|---|---|
| 1 | Planning |
| 5 | Leading |
| 6 | Controlling |

## 1. Overview

A code of conduct, also referred to as a code of ethics or code of business conduct, is a guide for individual conduct within an organization. More comprehensive than a value statement, a code of conduct explicitly states standards of professional conduct expected of an individual and helps clarify a company's vision, mission, values and guiding principles. Compliance with the code should be monitored and enforced to ensure that both ethical values (such as integrity, trust and social responsibility) as well as organizational values (such as excellence, responsibility and leadership) are embraced and promoted.

A well-written and thoughtful code of conduct serves the following purposes:

- Establishes a framework for professional behaviour and responsibilities and serves as a tool to improve how employees or members of the company deal with ethical issues and conflict situations;

- Serves as a communication vehicle that reflects and upholds a company's most important values and its standards for doing business; and

- Assists a company in creating a positive public identity and increases the public confidence of stakeholders.

According to the International Good Practice Guidance – Defining and Developing an Effective Code of Conduct for Organizations issued by the International Federation of Accountants, the key principles of developing a code of conduct are as follow:

- The organization's overarching objective should be to develop a values-based organization and a values-driven code, to promote a culture that encourages employees to internalize the principle of integrity and practice it, and encourages employees to "do the right thing" by allowing them to make appropriate decisions.

- A code of conduct reflects organizational context. The nature, title and content of an effective code will vary between organizations, as will the approach to its development.

- Commitment from board of directors: Ultimately, ethical responsibility lies with the board of directors (or its equivalent), the body that has power to influence an organization's culture and behaviour. Boards should specifically oversee the development of the code of conduct (and a wider initiative to achieve a values-based organization), and formally appoint a senior manager to supervise that development.

- A multi-disciplinary and cross-functional group including international personnel should lead code development where organizational size permits. Groups of employees and other key stakeholders can help to identify risks to corporate culture and business conduct and consider potential vulnerabilities arising from these risks and can usefully assist in defining and reviewing code content.

- Clearly identifying the established process for defining, developing and reviewing a code will promote understanding of, and agreement on, the key stages and activities.

- A code of conduct should apply across all jurisdictions in which an organization operates, unless contrary to local laws and regulations.

- Continuous awareness and promotion of the code and the wider approach to ethics and compliance is an important part of conveying management's commitment to their underlying principles. A continuous awareness program should sustain interest in and commitment to the code. Employees and others should be made aware of the consequences of not adhering to the code.

  For details of the International Good Practice Guidance – Defining and Developing an Effective Code of Conduct for Organizations, please refer to the Section 6-"Further Readings".

## 2. What You Can Do

Developing and implementing an effective code of conduct consists of four key steps as follows:

**2.1**. **Prepare:** In preparation for creating a code of conduct it is important to consider all the elements that could affect the way the organization projects itself and does business. The preparation process may consist of some of the following steps:

- Appointment of a multidisciplinary development team that consists of personnel from human resources, risk management, compliance and communications functions.
- Identify stakeholders whose conduct may affect the organization.
- Define a methodology for creating the code of conduct that can be repeated.
- Identify legal and industry specific requirements that need to be addressed.

**2.2. Create:** Once elements that can affect the public image and functioning of an organization are identified, a code of conduct can be created in order to address these issues.

**Guidelines to creating an effective code of conduct**

Content, context, tone and language are aspects of a code of conduct that decide how effective it is in promoting the values and principles of the organization. Some guidelines to writing an effective code are as follows:

- Avoid using 'legal speak' but rather use language appropriate for the general audience the code is attempting to address.
- Provide clarity by giving specific examples of accepted and unaccepted behaviour with suggestions on when to seek guidance.
- Determine the level of detail of the code of conduct based on the size of the organization.
- Unlike a corporate compliance document, which is more like a checklist, a code of conduct should be flexible enough for individuals to use to address both foreseen and unforeseen situations.

A code of conduct should be tailored according to the organization's specific needs and may address items such as the philosophy and values of the organization, accepted behaviour, proper use of organization's assets, conflict of interest situations, reporting of misconduct, repercussions for violators, substance abuse and compliance with laws and regulations.

### The creation process

Various organizations undertake the creation of a code of conduct by different methods depending upon the unique requirements of the organization at that point in time. A suggested process of creating a code of conduct is as follows:

- Draft an outline of the proposed code of conduct and obtain the comment and initial approval from management;
- Draft the code of conduct based on the approved outline;
- Obtain feedback from different levels of personnel by using methods such as focus groups;
- Circulate the code of conduct to legal advisors for review;
- Present the code of conduct to senior management and board of directors and obtain approval.

### Sample contents for a code of conduct

A well-designed code of conduct should state clearly and concisely the company's expectations, outline acceptable behaviour, and present viable options for employees to ask and voice concerns. The following are the suggested structure and content of a code of conduct:

- An introductory letter from senior management that sets the tone at the top and defines the importance of ethics and compliance to each employee and company;
- The company's vision, mission statement, values and guiding principles;
- An ethical decision framework to assist employees in making decisions. For example, a code might ask employees to answer some questions to guide them in making ethical decision about a possible cause of action and encourage them to think about this type of question in the context of an ethical dilemma. For example, "Would you be unwilling or embarrassed to tell your family or co-workers about your decision or behaviour?"
- Some of the potential issues or topics that are relevant to the company's business and the expected ethical behaviour are listed below:
    - Accurate operational and financial records and reporting;
    - Anti-trust/fair competition/competitive Information;
    - Confidentiality and proprietary information;
    - Customer/vendor relationships and contract confidentiality;
    - Conflict of interest;
    - Communications on behalf of the company (e.g. media and public relations);
    - Corporate governance;

- Environment, health and safety;
- Gifts, entertainment, gratuities to/from customers and vendors;
- Money laundering;
- Personal conduct;
- Procurement/purchasing;
- Quality of work;
- Social responsibility;
- Use of company resources (e.g. computer, network, e-mail and property, etc.);

- A listing of available resources for obtaining guidance and reporting of suspected misconduct; and
- Enforcement and implementation mechanisms that address the notion of accountability and discipline for unethical behaviour.

**2.3. Publish and promote:** The key to success of a code of conduct is management's commitment to uphold and promote the values and principles set forth by the code. Management can take the following steps to ensure that the code is effectively propagated across the organization:

- Circulate the approved code of conduct to all employees. The company may require all employees to acknowledge that they have read it and understand their compliance responsibility;
- Conduct training on the code of conduct and include it as part of the new hire orientation program; and
- Publish the code of conduct in the company's intranet and website.

**2.4. Monitor and review:** After establishing the code of conduct, it is the responsibility of management and board of directors to ensure compliance with the code. In organizations experiencing rapid growth and expansion it is necessary to review the code of conduct regularly to ensure that it remains relevant and effective. The followings are some methods by which management can monitor and review the code of conduct:

- Perform regular surveys of individuals across the organization to obtain their views on the relevance and effectiveness of the code of conduct. Reports should be submitted to and reviewed by senior management and board of directors on a regular basis.
- Establish an internal reporting mechanism, such as "integrity-hotline" program and provide a channel for employees to report suspected violations. Reported issues should be handled by independent personnel and reviewed by senior management and board of directors in a timely manner.

- Management should take disciplinary actions in cases where violation of the code is confirmed after investigation in order to display their commitment to upholding the code of conduct.

## 3. Benefits/Limitations

**3.1. Benefits.** Establishing a code of conduct is a key element for strengthening corporate culture and values. It assists the company to achieve its goals and objectives by aligning employee's behaviour with the company's expectations. It also discourages dishonest or deceptive practices, promotes company's reputation and strengthens stakeholders' confidence.

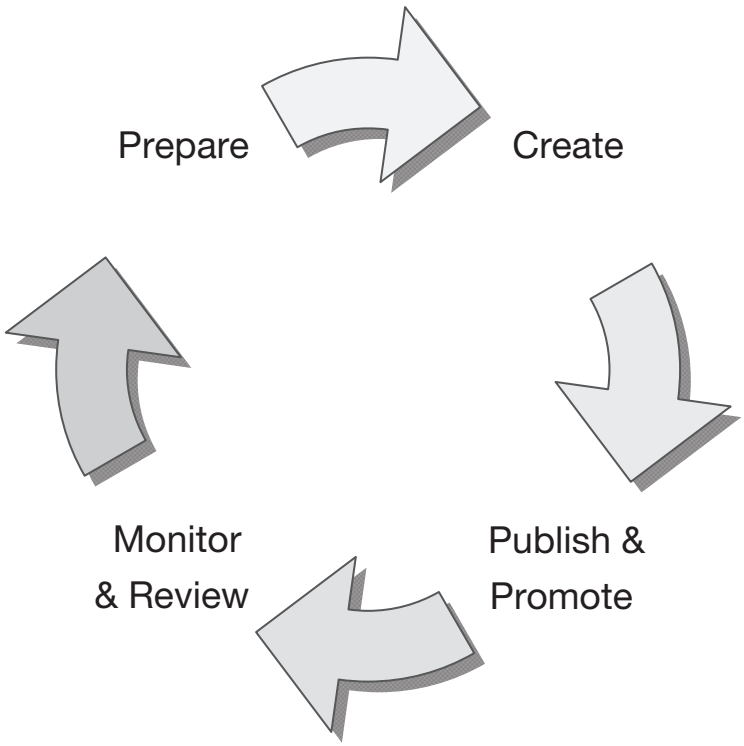
**3.2. Limitations.** The effectiveness of a code of conduct depends on whether it is properly put in place and implemented. It could be affected by management override, human judgment and behaviour of individuals. As such, supplementary controls, such as regular training, internal audit, whistle-blowers, etc., should be in place to reinforce and monitor the compliance of the code.

## 4. Considerations for Business in Mainland China

When developing a code of conduct for business in Mainland China, management should consider the requirements of the local laws and regulations. Management should also emphasize the importance of intellectual property rights governing the use of design, formulas and technology. In Mainland China, there are no comprehensive laws and regulations governing bribery. In such case, employees can make secret profits without the employers' consent and knowledge. Therefore, company should emphasize the importance of the prevention of rebate and bribery in the code of conduct in order to uphold the ethical values of the company.

## 5. Tools, Templates and Illustrations

**Illustration 5.1: Code of conduct development process**



**Template 5.2: Sample Code of Conduct Table of Content**

1. Message from the Chairman/CEO

   *[This can be an introductory letter from senior management to introduce the purpose and emphasize the importance of the code]*

2. Company's Mission, Vision and Values

   *[The company's mission, vision and values should be stated and explained in this section]*

3. Ethical Decision Framework

   *[The purpose of this framework is to assist employees to make ethical decision]*

4. Confidentiality

5. Conflict of Interest

6. Environmental, health and safety

7. Customer/Vendor Relationships

8. Gift and Entertainment Policy

9. Personal Conduct

   *[Various Topics]*

10. Reporting Channel – "Whistle-blower Program"

    *[Provide an independent reporting channel of suspected irregularities]*

11. Non-compliance and Disciplinary Actions

    *[Document the monitoring action and disciplinary actions in relation to non-compliance]*

## 6. Further Readings


- "International Good Practice Guideline – Defining and Developing an Effective Code of Conduct for Organizations." The International Federation of Accountants Publication. http://www.hkiod.com/e_news/other_events/2008/ifac_guide.pdf

- "Suggested Guidelines for Writing a Code of Ethics/Conduct." Deloitte Publications. http://www.deloitte.com/dtt/research/0,1015,sid%253D7108%2526cid%253D153552,00.html

- Technical Manager of Professional Accountant in Business Committee. "Defining and Developing an Effective Code of Conduct." International Federation of Accountants, 2006.

- "Sample Code of Conduct for Non-Governmental Organization." Independent Commission Against Corruption of Hong Kong SAR.

- "Defining and Developing an Effective Code of Conduct for Organizations". International Federation of Accountants (IFAC). 2007.

- "OCEG Foundation v1 (Red Book)". Open Compliance & Ethics Group (OCEG). 2007

***Appendix: Health Checklist on Corparate Ethics Programme***

***1. Setting One Common Standard – Company Code of Conduct***

| | Yes | No |
|---|---|---|
| **Does my company have a code of conduct to provide guidelines on ethical standards for all directors and employees?** | ○ | ○ |
| **Does the code cover the areas below for members of the Board of Directors and staff to follow?** | | |
| • Solicitation and acceptance of gifts and other advantages | ○ | ○ |
| • Offering of advantages to others to obtain business or for the purpose of influencing others in business dealings | ○ | ○ |
| • Acceptance of entertainment | ○ | ○ |
| • Observing local laws when working in other jurisdictions | ○ | ○ |
| • Declaration of conflict of interest | ○ | ○ |
| • Handling of confidential information and company property | ○ | ○ |
| • Relations with suppliers and contractors | ○ | ○ |
| • Channels for enquiries and complaints | ○ | ○ |
| • Penalty for violating the code | ○ | ○ |
| **Is there a designated officer with appropriate level of authority to deal with reports on advantages received, conflict of interest declarations and other matters relating to the implementation of the code?** | ○ | ○ |
| *If yes, title of the designated officer:* _____ | | |
| *Is his/her rank appropriate?* | ○ | ○ |
| **Is there a mechanism to constantly remind directors and staff of the contents of the code?** | ○ | ○ |
| **Are other stakeholders including suppliers, contractors and business partners well informed of the code, especially the policy on acceptance of gifts, other advantages and entertainment?** | ○ | ○ |
| **Is the code regularly reviewed to meet the current and future needs of the company?** | ○ | ○ |
| *If yes, when was the last review conducted:* _____ | | |
| ☛***Is it opportune to review the code now?*** | ○ | ○ |

### *2. Cultivating Ethical Mind – Corporate Training and Integrity Projects*

| | Yes | No |
|---|---|---|
| **Does my company use the following channels to communicate corporate values and ethics management to directors and employees?** | | |
| • Induction programmes for newly recruited staff on their legal obligations and our company code | ○ | ○ |
| • Ethics or compliance training : | | |
| * for directors on ethics management and their responsibilities | ○ | ○ |
| * for department heads on managing staff integrity | ○ | ○ |
| * for middle managers on their role of upholding staff integrity and preventing corruption in the workplace | ○ | ○ |
| * for frontline staff on the common corruption pitfalls and the skills to handle ethical dilemmas at work | ○ | ○ |
| • Internal communication channels, e.g. circulars, newsletters, posters, intranet, etc. | ○ | ○ |
| • Staff integrity projects, e.g. exhibition, quiz, various competitions, etc. | ○ | ○ |
| • Other training courses/channels: (please specify) _____ | | |
| ☛ ***Is it opportune to arrange the training courses now?*** | ○ | ○ |

### *3. Plugging the Loopholes – System Controls*

| | Yes | No |
|---|---|---|
| **Does my company adopt system controls (e.g. operational guidelines, procedures, control mechanisms, etc.) in the following functional areas?** | | |
| • Procurement | ○ | ○ |
| • Contract Management | ○ | ○ |
| • Sales and Marketing | ○ | ○ |
| • Finance and Accounting | ○ | ○ |
| • Human Resources Management and Administration | ○ | ○ |
| • Inventory and Stock Control | ○ | ○ |
| • Use of Information Technology | ○ | ○ |
| • Regular Internal Audits | ○ | ○ |
| • Others: (please specify) _____ | | |
| **Do system controls for the above functional areas align with my company's corporate ethics principles (e.g. emphasising integrity and capabilities in recruitment and staff promotion, setting realistic marketing goals, etc.)?** | ○ | ○ |
| **Are the policies and operational manuals/procedures/guidelines regularly reviewed?** | ○ | ○ |
| *If yes, when was the last review conducted :* _____ | | |
| ☛ ***Is it opportune to review these system controls now?*** | ○ | ○ |

The checklist is provided by Hong Kong Ethics Development Centre, ICAC
Tel: (+852) 2587 9812 Fax: (+852) 2519 7762 Email: hkedc@crd.icac.org.hk
Website: www.icac.org.hk/hkedc

The Hong Kong Institute of Directors

Corporate Governance Toolkit

# Develop Disaster Recovery Plan

Reference and page number in “Guidelines on corporate Governance for SMEs in Hong Kong”

| **Reference number** | **Page** | **Title → subtitle in Guidelines** |
|---|---|---|
| 2.1.3 | 14 | What governance practices do Hong Kong SMEs need? → The need for good governance |

Management practice cycle (“Guidelines on corporate Governance for SMEs in Hong Kong” page 8)

| **Cycle Number** | **Management practice cycle** |
|---|---|
| 1 | Planning |

# 1. Overview

Disaster recovery is the process that ensures the continuity of a company's business operations when a disaster strikes. This process not only focuses on the recovery of the essential functions and systems of a company, but also emphasizes its recovery within the shortest possible time. To achieve maximum recovery in minimal time, a route map known as a disaster recovery plan detailing the actions to be performed before, during, and after a disaster is of great importance.

Elements that are often considered in a disaster recovery plan include data, hardware and software, physical assets, departments and documentation.

The management and departments who will be responsible for disaster recovery should be involved in creating the disaster recovery plan. The creation of the plan by the employees of a company ensures complete and dedicated effort. SMEs can also consider hiring a consultant or an external specialist to tailor the plan if they lack the special-skills or expertise in this area. The plan should be distributed to the owner in a small size company and the CEO, senior management and key departments in a medium size company so that everyone understands his/her responsibilities well and be aware that a plan for disasters is in place. In addition, sections of the plan should be shared with the community disaster response agencies. The plan should also be communicated to stakeholders such as business partners, service providers, and investors.

Depending on how often changes to business operations take place, the disaster recovery plan should be reviewed and updated accordingly on a constant basis, i.e. semi-annually, annually, or over even longer periods.

# 2. What You Can Do

## 2.1. Identify inputs for disaster recovery planning

The plan should include extensive information regarding the following:

- Description of the roles and responsibilities of the individuals involved in disaster recovery
- Coordination of the company with local agencies
- Procedures for notification and communications of disasters to external authorities and stakeholders
- Procedures for notification of departments when disaster response measures are initiated
- Management of scheduling, modification, and discontinuation of services
- Management of staff or family-support activities
- Management of logistics of critical supplies
- Management of security, facility evacuation procedures
- Tracking the movement of critical information and resources to a secure site
- Protocols for including agencies in disaster recovery procedures

- Names, telephone numbers, and other contact numbers of key recovery departments
- Procedures for training, implementing, testing, and maintaining the disaster recovery plan
- Implementation of changes to user procedures, upgrading existing data processing operating procedures to support selected recovery strategies and alternatives
- List of resources — such as departments, equipment, and tools — that are required to perform a recovery task.

### 2.2. Compose the contents of a disaster recovery plan

Although the contents of a disaster recovery plan may vary from one company to another, the main components of a disaster recovery plan remain the same and include the following:

- **Executive summary/purpose statement.** The executive summary gives an overview of the purpose of the disaster recovery plan. This section of the plan also states the company's disaster management policy. The disaster management policy includes information related to the coordination with the local bodies. This policy forms the basis of the disaster recovery and resumption procedures. In addition, the summary defines the roles and responsibilities of key disaster recovery departments and lists the different types of disasters that are likely to impact the enterprise. The policy also specifies the locations where the response operations will be managed.
- **Disaster recovery procedures.** The disaster recovery procedures section of the disaster recovery plan includes measures about how the facility will respond to a disaster. While developing these procedures, a company should consider the actions to be performed to assess the disaster situation and protect employees and assets on the premises of the facility and the procedures required to restore business operations. In addition, specific procedures for purposes such as shutting down operations, evacuating premises, and warning employees and customers should also be mentioned.
- **Supporting documents.** The supporting documents section of a disaster recovery plan includes information required during a disaster to effectively carry out the disaster recovery procedures. Such information includes items such as a list of resources (equipment, supplies, and services) that might be needed in a disaster and a list of departments involved in responding to disasters with their roles, responsibilities, and telephone numbers. The design of facilities and site maps indicating details such as exits, escape routes, floor plans, and the location of fire extinguishers are also included. Further, all the agreements with other companies and government agencies pertaining to disaster recovery are included.

### 2.3. Implementation of the disaster recovery plan in the entire company

After a disaster recovery plan has been created, the implementation process takes into place which involves steps below.

- Communicate with the individuals mentioned in the disaster recovery plan about their respective roles and responsibilities.
- Make all newly recruited employees aware of the disaster recovery plan.

- Specify the roles and responsibilities found in the disaster recovery plan in the documentation of the procedures for specific departments.

- Communicate any modifications in the plan to the employees as and when the plan is updated.

## 3. Benefits/Limitations

**3.1. Benefits.** The benefits of developing a disaster recovery plan are safety and welfare of the people on the premises at the time of disaster. Also, a good disaster recovery plan provides protection of critical information and records, protection of business sites and facilities, protection and availability of materials, supplies, and equipment for the safety and recovery of vital records, minimization of the occurrence and duration of disasters, reduction of the immediate damage and loss. It also provides for recovery of damaged and lost records or information after a disaster, reduction of the complexity of the recovery effort, coordination of recovery tasks, etc.

**3.2. Limitations.** The disaster recovery plans will vary from industry to industry and have differences even among companies in the same industry. Owners or management of small or medium size companies may lack the expertise of developing a comprehensive disaster recovery plan and need to hire outside advisors, which will increase the costs of operation. In addition, only by conducting test in an actual crisis scenario will the owner or the manager be able to identify practical recovery alternatives and decide upon in order to bring out the shortcomings in the disaster recovery plan.

## 4. Tools, Templates and Illustrations

### Template 4.1: Disaster Recovery Plan Template

**Company XXX**
**Template of a Disaster Recovery Plan**
For the year ending--/--/--

**Department:** _____
**Prepared Person/Team:** _____
**Date:** _____

I. **Purpose Statement** (e.g., to provide established procedures for surviving/recovering from a disastrous event in order to reestablish normal business operations)
II. **Scope of Procedures** (To whom and what do the procedures apply?)
III. **Disaster Recovery Plan Planning Assumptions**
IV. **Organizational Process for Developing, Approving, and Updating of the Disaster Recovery Plan**
    A. Normal Operating Procedures
        1. Standard Operating Procedures/Operational Instructions
        2. Backup Procedures
        3. Disaster Prevention Measures
    B. Procedures Used during a Disaster
        1. Emergency Notification Procedures
        2. Safety Procedures for On-Site Personnel during a Disastrous Event
        3. Continued Operations Procedures for Critical Functions
        4. Procedures for Maximizing Protecting/Minimizing Disruption to Critical Assets
    C. Post-Disaster/Recovery Procedures
        1. Procedures for Damage Assessment
        2. Procedures for Short-Term, Medium-Term, and Long-Term Outages
        3. Recovery of Organizational Assets
            a. Facilities
            b. Communications
            c. Hardware
            d. Software
            e. Databases/Data Files
            f. Operational Functions
            g. Customer Services
            h. Other
        4. Critical Systems and Prioritized Order of Recovery
        5. Alternative Plans for Continuity of Operations
        6. Alternate Operational Sites/Hot Sites
            a. Remote Management Services
            b. Vendor Consignments
            c. Other

Appendix A: References
Appendix B: Organizational Process for Disaster Recovery Plan Testing
Appendix C: Risk/Business Impact Assessment of the Organization
Appendix D: Memorandums of Agreement
Appendix E: Inventories
- Telephone Contact List/Employee Recall Roster
- Customer Lists/Distribution Lists
- Documentation (Critical Information, Forms, Policies/Procedures/Checklists)
- Equipment (Hardware, Software, Communications/Telephone, Photocopiers/Facsimile machines, etc.)
- Property Book Inventories/Office Supplies
- Off-Site and Temporary Storage Site lists

Appendix F: Associated Service and Maintenance Costs
- Recovery and Backup Services and Equipment Fees

Appendix G: Disaster Recovery Plan Training and Awareness Program

**Company XXX**
**Template of a Disaster Recovery Plan**
For the year ended--/--/--

**Department:** _____
**Prepared Person/Team:** _____
**Date:** _____

1. **Emergency Action**—Procedures for reacting to crises, ranging from activation procedures to emergency evacuations.

2. **Notification**—Procedures for notifying relevant managers in the event of a disaster. A contact list of home and emergency telephone numbers is typically provided as an appendix for easier updating.

3. **Disaster Declaration**—Procedures pertaining to the assessment of damage following a disaster, criteria for determining whether the situation is a disaster, and procedures for declaring a disaster and invoking the plan.

4. **Systems Recovery**—Procedures to be followed to restore critical and vital systems at emergency service levels within a specified time frame in accordance with the systems recovery strategy defined in the plan.

5. **Network Recovery**—Procedures to reinstate voice and data communications at emergency service levels within a specified time frame in accordance with the network recovery strategy defined in the plan.

6. **User Recovery**—Procedures for recovering critical and vital user functions within a specified time frame in accordance with planned strategy.

7. **Salvage Operations**—Procedures for salvaging facilities, records and hardware, often including the filing of insurance claims and the determination of the feasibility of reoccupying the disaster site.

8. **Relocation**—Procedures for relocating emergency operations (system, network, and user) to the original or a new facility, and the restoration of normal service levels.

## 5. Further Readings

- Philip Jan Rothstein. “Disaster Recovery Testing: Exercising Your Contingency Plan.” 2007.

- Michael Wallace and Lawrence Webber. “Disaster Recovery Handbook, The: A Step-by-Step Plan to Ensure Business Continuity and Protect Vital Operations, Facilities, and Assets.” 2004.

- Jon William Toigo. “Disaster Recovery Planning: Preparing for the Unthinkable.” 2002.

# The Hong Kong Institute of Directors

# Corporate Governance Toolkit

# Communicate with Stakeholders

Reference and page number in “Guidelines on corporate Governance for SMEs in Hong Kong”

| **Reference number** | **Page** | **Title → subtitle in Guidelines** |
|---|---|---|
| 2.1.10 (b) | 15 | What governance practices do Hong Kong SMEs need? → The need for good governance |
| 2.5.17 | 31 | What governance practices do Hong Kong SMEs need? → Category 4 |

Management practice cycle (“Guidelines on corporate Governance for SMEs in Hong Kong” page 8)

| **Cycle Number** | **Management practice cycle** |
|---|---|
| 1 | Planning |
| 4 | Organising |
| 5 | Leading |

## 1. Overview

Communication is an essential requirement in any organization regardless of their stage of development internally and externally. Clear communication is required both internally and externally to ensure key stakeholders and customers are updated on business plans and need to know information. Successful communication with stakeholders depends on the relationship amongst the various parties. A good relationship is based on trust and respect. Proper communication eliminates misperception and misunderstanding and if done in a proactive and timely fashion will build trust and confidence from these same stakeholders.

Communication informs the various stakeholders (e.g. customers, creditors, employees, suppliers and the external community, etc.) about the need for change and the consequences of the proposed change. Educational efforts prevent false rumors, misunderstanding and resentment. Communication often gives management an opportunity to explain what steps will be taken to ensure that the change will have no adverse consequences on stakeholders.

## 2. What You Can Do

**2.1. Develop communication principles and objectives.** A sound communication plan requires a set of guiding principles. Guiding principles are fundamental assumptions that are used when developing and evaluating all communications. They serve as "directional signs" that help those who develop and deliver communications stay on path, and also guide the objectives of the communication plan. Communication objectives, in conjunction with the communication guiding principles, help those who craft and deliver messages evaluate the messages they deliver and measure the effectiveness of their communications. Communication that doesn't achieve the defined objectives can indicate that resources have not been used in the most effective manner. As a result, defining communication objectives and ways to measure how well the objectives are being met are important elements to a communication plan.

**2.2. Conduct stakeholder and audience analysis.** A stakeholder and audience analysis is used to identify the unique context of each stakeholder, as well as the most appropriate communication approach for stakeholder groups. A stakeholder matrix is used to map stakeholders according to:

- Influence: Level of influence on the success of the information
- Impact: Level of impact experienced in their day-to-day activities in relation to the information.

The stakeholder matrix provides a guideline on how to approach and engage each stakeholder group in the communications process. Detailed descriptions of this matrix, as well as the stakeholder analysis, are provided on page 14 of the Communication Strategy and Plan Template in Section 4. The key steps of conducting a stakeholder and audience analysis are summarized as below:

- Identify stakeholders;
- Understand the situation;
- Assess level of support;
- Rate impact on project success;

- Determine desired role on project;
- Map stakeholders to matrix;
- Develop action plan;
- Audience analysis; and
- Validation and approval.

**2.3. Develop key messages and media analysis.** A media analysis is an audit and assessment of the existing methods a company uses to communicate information. The objective of the media analysis is to understand the communication vehicles currently in use, how they are used, and which forms are most effective. This information assists in the selection of the most appropriate communication vehicles and/or the creation of new communication vehicles to deliver the project messages and information. Typically, a variety of different communication vehicles are used to communicate. At a high level, the various communication vehicles can be grouped in the following manner:

- Person-to-person. Enable a "live" exchange of information, face-to-face meetings, audio or video conferencing, and other communication mechanisms are enhanced.
- Printing materials. Consist of hard-copy communication vehicles, such as newsletters, flyers and posters.
- Electronic. Consist of a wide array of computer-based communications, such as e-mail, electronic newsletters, websites and webcasts.

Each of these categories of communication vehicles has strengths and weaknesses. While person-to-person communications are typically the preferred and most effective way of communication, solely relying on person-to-person communications is not practical or "do-able." The media analysis will assess the various types of communication vehicles available to your project and determine when each of the communication vehicles is appropriate or recommended for project communications. For the detail explanations of the strengths and weaknesses of different communication vehicles, please refer to page 20 of the Communication Strategy and Plan Template in Section 4.

Over the communication process, different messages and pieces of information will need to be shared with various stakeholder groups inside and outside of the organization. The message analysis identifies which key messages need to be disseminated to the various stakeholder groups and when these messages should be disseminated. The message analysis is then incorporate with the media analysis and stakeholder analysis to determine how key messages will be delivered to which groups of individuals and when these messages will be delivered.

**2.4. Develop communication plan.** To develop the communication plan, managements need to review all existing documents and the documentation regarding the communicating information. The series of detailed messages that need to be delivered to the organization can be grouped into themes or activities. These themes should be summarized in the communication plan, along with advice on how to determine the frequency of these messages. For detail, please refer to page 24 in the Communication Strategy and Plan Template in Section 4.

**2.5. Collect feedback.** The communication plan is designed to achieve the communication objectives defined for the project. However, there is a need to be proactive in measuring performance against objectives. The reasons for collecting feedback are to promote two-way communications, engage stakeholders in communications and the project, monitor the effectiveness of communications and capture information to modify the project communication plan to meet the desired communication objectives. Mechanisms to collect feedback to measure the performance can be both formal and informal, such as conducting electronic feedback survey, asking questions during regular meetings, etc.

## 3. Benefits/Limitations

**3.1. Benefits.** By developing a good communication strategy, it lowers the number of barriers to implement required changes and keeps the misunderstanding within various stakeholder groups to a minimal. It is the best method to gain support from the stakeholders in implementing changes.

**3.2. Limitations.** By preparing the stakeholders with sufficient information in an organized fashion, this allows smooth transition and implementation required but as this process is not easy to implement, hence it has the possibility to create mass amount of paper work and productivity of the industry/ company could decrease during the period.

# 4. Tools, Templates and Illustrations

## Communication Strategy and Plan Template

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**Before getting started: About the Communication Tool Kit**

The Communication Tool Kit provides a best practices methodology for the creation of a communication strategy and plan to support enterprise-wide projects that include an internal communications component. This methodology can be used by any or all projects that need to complete a communications strategy. The Communication Tool Kit can also be used to manage communications strategies across multiple projects.

The Communication Tool Kit consists of the following:

- Communication Strategy and Plan (this document)
- Workbook
- Templates

How to use these documents:

**The Communication Strategy and Plan** is used in conjunction with the Workbook, and can also serve as a presentation document for your project sponsor(s). As you proceed through the document and complete this communication strategy, enter your (Project Name) where needed in the text. An appendix is provided and includes links to the templates referenced below. The appendix and all shaded areas in your final strategy document can be deleted after you complete the Communication Strategy and Plan. Or you can keep the appendix and replace the reference links with your completed templates and Workbook.

**The Workbook** will record each step of the process and be used populate the Communications Strategy and Plan, providing detailed information that can be attached as an appendix for your project sponsor(s). A link to this Workbook can be found on page 159. You will need to access and open this link, print out the instruction tab and complete the templates for input into this strategy and for your final communication plan. Once completed, the Workbook should then be linked to this final document.

**The Templates** are companion documents to support for you in managing the communications component of your project.

**Document control**

Document Title: Communication Strategy
Project: (insert project name)
Document Owner: (insert name)

| Version | Date | Status/ Comments | Page No. Changed | Reviewed/Approved | |
|---|---|---|---|---|---|
| | | | | Name | Date |
| | | | | | |
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**Introduction**

The **(Project Name)** Communication Strategy and Plan and Workbook are living documents and are expected to change throughout the course of the project, according to communication needs and the effectiveness of communication vehicles.

Successful change leadership requires communication, and the engagement of employees through effective, interactive communication processes. The **(Project Name)** Communication Strategy and Plan provides an overview of all associated communication and engagement activities for the project.

The plan presents a detailed description of the key communication and engagement activities for each identified stakeholder group. The activities in this plan are mapped against common events, **(Project Name)** milestones and/or deliverables.

The strategy and plan will lay the foundation for communications during subsequent phases of **(Project Name)**, and will serve as a model or template for ongoing communication efforts.

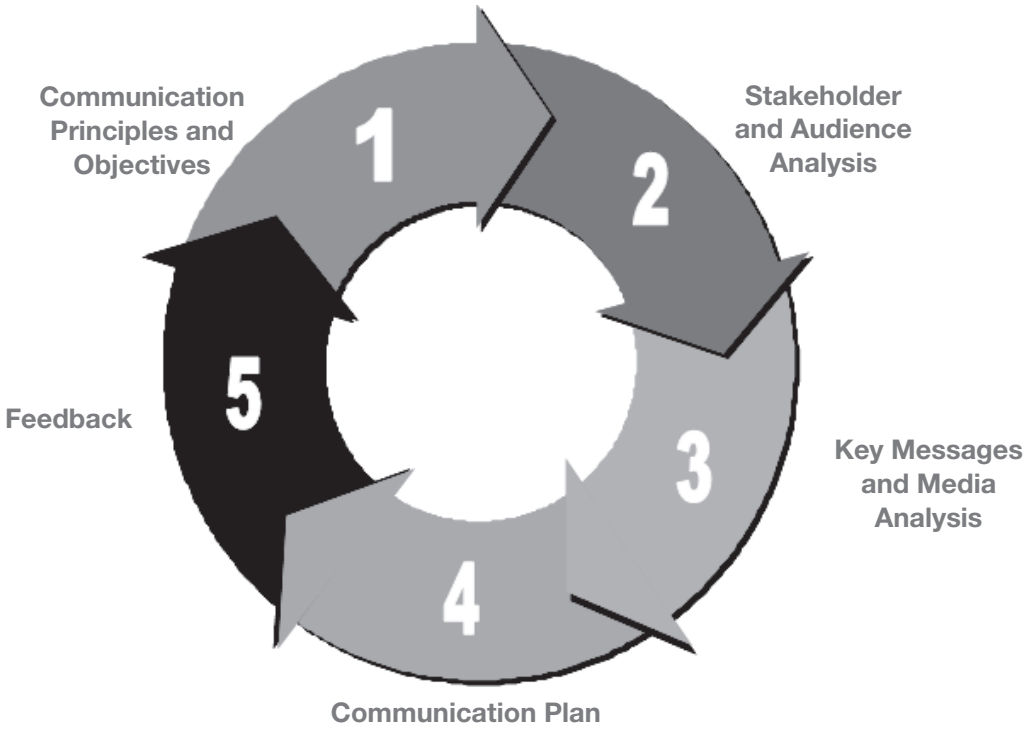
The **(Project Name)** Workbook is the basis of the Communication Strategy and Plan and provides in-depth information and analysis. This Workbook can be provided as a reference document.

**Communication Strategy:** A communication strategy is a document that outlines the strategy to use to communicate the key objectives to stakeholders. By following the communication steps outlined in this document and completing the necessary templates, the communication strategy determines who, when, what, why and how this communication strategy will take place.

**Communication Plan:** A communication plan is a written statement of what communication actions will be taken to support the accomplishment of specific objectives, the time frame for carrying out the plan and how to measure the results. The plan will be built following the completion of the Communication Tool Kit Workbook.

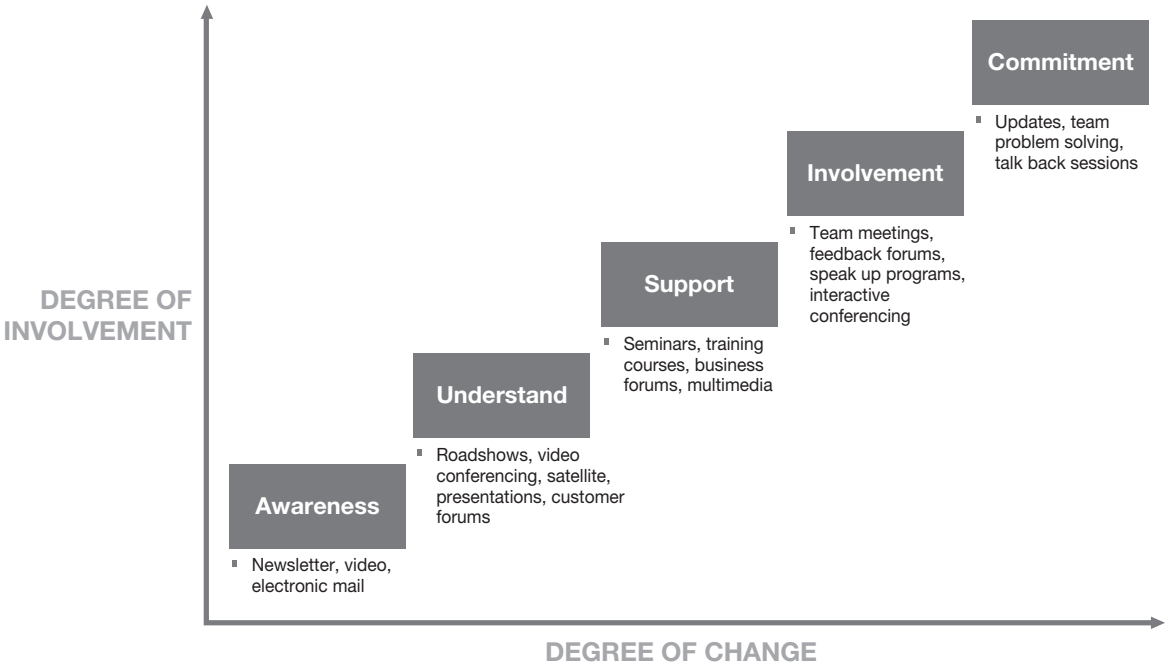
### Communication methodology

The approach to develop a communication strategy and plan is based on a logical sequence of steps that focus on identifying key groups impacted by the project, key messages the groups need to receive, and appropriate delivery mechanisms for the messages.



### Approach

Simply ensuring that stakeholders "understand" the new communication is not enough; engaging them in the process through concrete "commitment" will be required. The challenges associated with moving the stakeholders from "awareness" to "commitment" (stakeholders ownership) should not be underestimated. The "Communication Escalator" outlined below is a proven process that moves stakeholders from awareness to commitment in a structured fashion.



Source: Bill Quirke's Communication Escalator Model

**Communication strategy and plan tasks**

| Tasks | Approach | Inputs | Outcomes |
|---|---|---|---|
| **Communication Principles** | • Review preliminary information about the project and the organization.<br>• Gain consensus on communication principles by facilitating discussion with project leadership. | • Organizational information<br>• Guiding communication principles<br>• Project objectives | • Communication strategy (in progress)<br>• Communication principles |
| **Communication Objectives and Goals** | • Using the communication principles, draft a list of communication goals and objectives.<br>• Gain consensus on communication objectives and goals by facilitating discussion with project leadership. | • Organizational information<br>• Communication strategy (in progress)<br>• Communication principles | • Communication strategy (in progress)<br>• Communication objectives and goals |
| **Stakeholder Analysis** | • Identify stakeholders and create stakeholder profiles.<br>• Determine the actions necessary to achieve stakeholder buy-in.<br>• Create a leadership involvement action plan that lists activities, accountability and timing by stakeholder group. | • Organizational information<br>• Organizational charts<br>• Stakeholder checklist | • Stakeholder profiles<br>• Stakeholder matrix |

**Communication strategy and plan tasks (Cont'd)**

| Tasks | Approach | Inputs | Outcomes |
|---|---|---|---|
| **Audience Analysis** | • Compile data regarding membership, each group's characteristics, and specific communication needs.<br>• Determine the preferred method of communication for each group. | • Stakeholder profiles<br>• Stakeholder matrix | • Communication strategy (in progress)<br>• Audience analysis template |
| **Media Analysis** | • Produce a media matrix that includes items such as:<br>– Type<br>– Frequency<br>– Appropriateness<br>– Audience reach | • Communication strategy (in progress)<br>• Audience analysis template<br>• Media checklist | • Communication strategy (in progress)<br>• Media checklist |
| **Key Messages** | • Identify and develop targeted key messages and their supporting messages. | • Communication strategy (in progress)<br>• Audience analysis template<br>• Validated media checklist<br>• Reference material for key message development | • Communication strategy (in progress)<br>• Key messages |

**Communication strategy and plan tasks (Cont'd)**

| Tasks | Approach | Inputs | Outcomes |
|---|---|---|---|
| **Communication Plan** | • Develop a comprehensive communication plan for the entire project life.<br>• Reference the communication principles to be followed, the objectives to be achieved and the findings of the stakeholder, audience, and key message and media analysis. | • Project milestones/ plan<br>• Communication strategy (in progress)<br>• Stakeholder analysis<br>• Organizational constraints<br>• Available resources<br>• Roles and responsibilities template | • Communication strategy (in progress)<br>• Communication plan |
| **Initial Communications** | • Confirm communication roles as outlined in the communication plan.<br>• Create the message. Review the message for content and impact. If content will have a high impact, have it reviewed and approved by the project sponsor(s). | • Communication strategy (in progress)<br>• Communication plan<br>• Key communication messages | • Initial stakeholder communications |
| **Feedback Process** | • Continuously collect feedback during the ongoing implementation of the communication plan. | • Communication strategy (in progress)<br>• Communication plan<br>• Feedback checklist | • Communication feedback |

**Project background**

*[Enter a brief description of the background of the project. Include any pertinent information needed for people to know about the project that is not related to the project principles or objectives, which will be outlined on the following pages.]*

**Step 1: Communication principles and objectives**

**Step 1.1 Communication principles**

**What are communication principles?**

A sound communication plan requires a set of guiding principles. Guiding principles are fundamental assumptions that are used when developing and evaluating all communications. They serve as "directional signs" that help those who develop and deliver communications stay on path, and also guide the objectives of the communication plan.

These Communication Guiding Principles should be used for all Communication Strategies and Plans:

- The Public Affairs Advisor, Internal Communications should be involved in the creation of communications strategies and plans from the start of the project. Pre-determined validation periods are built into the methodology of the communication strategy and plan.
- All communication strategies should follow the methodology outlined in this document.
- The project manager and/or communication team is responsible for validating strategies, timeline and deliverables.
- The Advisor and project manager and/or communication team have final approval of the communication strategy and plan
- Any communications associated with <personnel names deleted> their review and approval. This must be built into the project plan and timeline. Their electronic signatures are managed through the Advisor and are never to appear in draft documents.

Important Note: Public Affairs will add to or modify these principles as warranted.

**(Project Name)** Communication Principles: *(Enter your communication strategy principles below.)*

- …
- …
- …
- …
- …
- …

### Step 1.2 Communication objectives

#### Why Define Communication objectives?

Communication objectives, in conjunction with the communication guiding principles, help those who craft and deliver messages evaluate the messages they deliver and measure the effectiveness of their communications.

Communication that doesn't achieve the defined objectives can indicate that resources have not been used in the most effective manner. As a result, defining communication objectives and ways to measure how well the objectives are being met are important elements to a communication plan.

The Project Manager and/or Communication Team will coordinate all official **(Project Name)** communications. The goal is to ensure that there is one point of contact for communication and one approach.

#### Examples of objectives are:

- to inform and engage the various stakeholder groups about **(Project Name)**, consequences of the proposed system and process changes, and their roles in making change happen;
- to involve these groups in an interactive, respectful and honest communication process throughout the **(Project Name)** lifecycle;
- to ensure that communication is delivered in a consistent manner; and
- to enroll stakeholders in a timely fashion, directly or indirectly, by informing, educating, persuading, soliciting input and motivating them to gain involvement throughout the project.

#### (Project Name) Communication Objectives

Objectives must be established for all organizational communication activities to determine the degree of impact that the communication strategy is having on the attainment of<Company X>'s overall goals. These communication objectives must be aligned with the objectives for the project and meet SMART criteria:

- **S**pecific
- **M**easurable
- **A**chievable
- **R**elevant
- **T**ime-bound

**(Project Name)** Communication Objectives: *(Enter your communication objectives below.)*

- …
- …
- …
- …
- …

*For reference information regarding the development of SMART objectives, see pages 160-161 in the appendix.*

**Step 1.3 Validation and approval**

*Each step should go through a validation and approval process. Upon completion of Step 1, clear and precise principles and objectives must first be established before Step 2 can begin.*

*Detailed instructions and a validation and approval process are provided in the appendix. See the link on page 168, (Project Name) Validation and Approval Process.doc, read the document for the procedures then complete the Step 1 validation checklist and send your document to Public Affairs for their review. Complete the Validation Log at the end of the document.*

**Step 2: Stakeholder and audience analysis**

A stakeholder and audience analysis will identify the unique context of each stakeholder, as well as the most appropriate communication approach for stakeholder groups. A stakeholder matrix is used to map stakeholders according to:

- Influence: Level of influence on the success of the project/program
- Impact: Level of impact experienced in their day-to-day activities in relation to the project/program

The stakeholder matrix provides a guideline on how to approach and engage each stakeholder group in the communications process. Detailed descriptions of this matrix, as well as the stakeholder analysis, are provided in appendix.

**Steps in conducting a Stakeholder Profile:**

**Step 2.1** – Identify stakeholders
**Step 2.2** – Understand the situation
**Step 2.3** – Assess level of support
**Step 2.4** – Rate impact on project success
**Step 2.5** – Determine desired role on project
**Step 2.6** – Map stakeholders to matrix
**Step 2.7** – Develop action plan
**Step 2.8** – Audience analysis
**Step 2.9** – Validation and approval

**Step 2.1 Identify and group stakeholders**

*The first step in this process is to identify and group your stakeholders. For a definition of stakeholders and how to identify stakeholders associated with your project, see page 162 of the appendix.*

*You will need to select your stakeholders from the Stakeholder Checklist template. The link to the Communication Tool Kit Workbook is on page 159.*

### Step 2.2 Understand the situation

Once the various stakeholders are outlined, interviews should be conducted in order to understand each individual's key concerns, their level of support and their level of impact on the project.

To facilitate the interview process, follow this step-by-step process:

**1. Set the stage**

The interviewer introduces him/herself to the interviewee, provides a high-level overview of the project background and initiatives, outlines the purpose and objectives of the interview, how the information collected during the interview will be used, and how it will be conducted.

**2. Ask/document questions and responses**

The interviewer asks the interviewee the questions listed on the Interview Questionnaire. For each question, the interviewer tries to elicit specific examples and incidents that may help clarify an answer provided by the interviewee. The interviewer also documents the responses to each question, taking as many detailed notes as possible.

**3. Wrap-up the interview**

At the end of the interview, the interviewer thanks the interviewee for his/her time and reiterates how this information will be used.

*Use the Stakeholder Questionnaire link in the appendix on page 162 to complete your interviews with your stakeholders. These are sample questions that can be modified as needed. These interviews will prepare you for completing the Stakeholder Matrix and the Stakeholder Profile templates.*

**Step 2.3 Assess level of support**

During the questionnaire interviews with the stakeholders, assessments of project support level and the commitment to long-term change should have been recorded.

*Enter this information by filling in the second column in the Stakeholder Profile. Use the Stakeholder Matrix as a guide to help position the assessments.*

*The Stakeholder Matrix and Stakeholder Profile are included in the Communication Tool Kit Workbook. The link to the Workbook is on page 159.*

**Step 2.4 Rate impact of project success**

Using the results of the questionnaire and using the Stakeholder Matrix as guidance, enter this information in the Stakeholder Profile by filling in the third column.

Having determined the information above, now enter the issues, needs and concerns that were identified by each stakeholder interviewed in column four of the Stakeholder Profile.

*The Stakeholder Matrix and Stakeholder Profile are included in the Communication Tool Kit Workbook. The link to the Workbook is on page 159.*

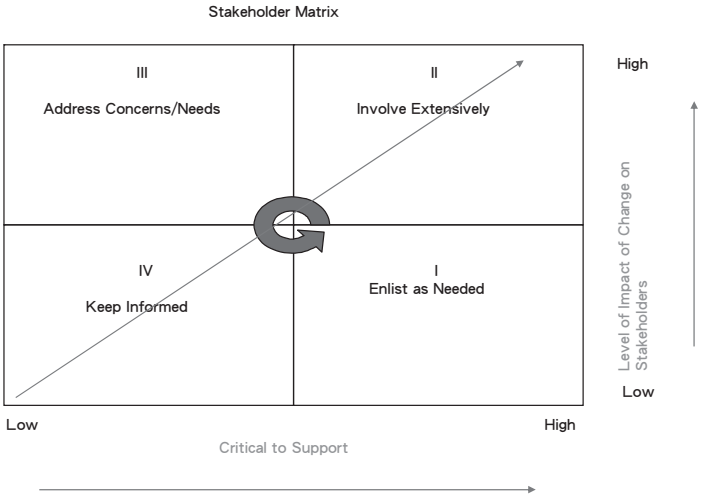
**Step 2.5 Determine desired role on project**

Having determined who the stakeholders are, what their level of support is, how they can impact the success of the project and what their issues and concerns are, now define what role each stakeholder should play for the project is to be successful. The roles of each stakeholder will be taken from the "Communication Escalator" model on page 142. This model details the increase from Awareness to Commitment, which relates to degrees of change and impact. Enter this information in column five of the Stakeholder Profile.

*The Stakeholder Profile is included in the Communication Tool Kit Workbook. The link to the Workbook is on page 159.*

### Step 2.6 Map stakeholders to matrix

The stakeholder matrix is used to categorize groups of stakeholders and help determine appropriate action plans.




| Stakeholders | Quadrant |
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*Complete the Stakeholder Matrix in the Communication Tool Kit Workbook. The link to the Workbook is on page 159. You can copy your answers from the Stakeholder Matrix in the Workbook to the template above or provide a link to your completed Workbook at the end of this document.*

*For a detailed description of each quadrant, see page 163.*

### Step 2.7 Develop action plan

At this point in the process, the Stakeholder Matrix should be complete and the Stakeholder Profile nearly complete, with the exception of the last column. Use the "Role for Project Success" column to develop the action plan that is needed to put in place to address the key issues, needs and concerns of each stakeholder.

### Step 2.8 Audience analysis

At this stage in the process, the stakeholders have been identified and the associated profile information entered in the Stakeholder Profile template. This information will automatically carry over to the Stakeholder column in the Stakeholder Matrix and in the Audience Analysis forms in the Communication Tool Kit Workbook.

To further segment the audience to analyze their needs, break them down into the following subgroups:

**Membership Count:** Number of individuals in the audience.
**Characteristics:** Detailed characteristics of the audience, which represents what is changing for them.

**Example**

- **Audience:** Customer Service
- **Membership Count:** Billings (12), Network (7), Quality Assurance (3), Help Desk (2), Supervisors (3)
- **Characteristics:** Ten supervisors within this group may or may not be directly impacted by the change immediately, but their assistance is needed. (Detail who the members of the count are so you can see if some individuals need to be communicated to in a different way).
- **Communication Needs:** The communication needs presents the specific information needs by the audience that can address his/her concerns or issues, e.g. progress of the project, how to use a new tool, etc.

After this information is entered in the spreadsheet, enter the communication needs that the identified audience requires and the communication channels that could be used.

*The Audience Analysis form is included in the Communication Tool Kit Workbook. The link to the Workbook is on page 159.*

### Step 2.9 Validation and approval

Upon completion of Step 2, go to the link on page 168 (Project Name) Validation and Approval Process. doc. Use the checklist for Step 2 and send your document for validation and approval before proceeding to Step 3.

*Complete the Validation Log at the end of the document. Upon return and approval of your document, proceed to Step 4.*

**Step 3: Key messages and media analysis**

**Step 3.1 Assess the current media analysis**

A media analysis is an audit and assessment of the existing methods<Company X> uses to communicate information. The objective of the media analysis is to understand the communication vehicles currently in use, how they are used, and which forms are most effective. This information assists in the selection of the most appropriate communication vehicles and/or the creation of new communication vehicles to deliver the project messages and information.

Typically, a variety of different communication vehicles are used to communicate. At a high level, the various communication vehicles can be grouped in the following manner:

- **Person-to-Person** – Includes face-to-face meetings, audio or video conferencing, and other mechanisms that enable a "live" exchange of information.
- **Print** – Includes hard-copy communication vehicles, such as newsletters, flyers and posters.
- **Electronic** – Includes a wide array of computer-based communications, such as e-mail, electronic newsletters, websites and webcasts.

*Each of these categories of communication vehicles has strengths and weaknesses. While person-to-person communications are typically the preferred and most effective way of communication information, solely relying on person-to-person communications is not practical or "do-able." The media analysis will assess the various types of communication vehicles available to your project and determine when each of the communication vehicles is appropriate or recommended for project communications.*

*To become more familiar with the various cultural intricacies, books on cultural diversity or even travel guides may be valuable sources of information. More importantly, if there are communication coordinators or Human Resource representatives in the countries where you need to communicate, refer to them to assist you in the communication strategy. Also seek stakeholders from the various sites that will be affected by the change to contribute to or validate the communication channels and messages you have identified for your project.*

*This exercise will only need to be done once. You can reuse this information for any additional communication strategies and plans you will need to complete.*

*Select the preferred media channels to use for this project from the list of existing media channels. For guidance in choosing your preferred media channel, see the "Strengths and weaknesses of communications vehicles" grid on the next page.*

*The Media Checklist is included in the Communication Tool Kit Workbook. The link to the Workbook is on page 159.*

### Strengths and weaknesses of communication vehicles

Each class of communication vehicles has inherent strengths and weaknesses. What is effective at one company may not be effective at another.

| | Advantages | Disadvantages |
|---|---|---|
| **Person-to-Person** | • Establishes relationship between communicator and recipient<br>• Conveys empathy more easily<br>• Supports two-way communications<br>• Facilitates assessment of audience understanding and receptiveness<br>• Increases credibility of message<br>• Allows language to be tailored to the audience | • Limits portability of message to other groups<br>• Places onus on employee to participate unless mandatory<br>• May require coaching and preparation of communicators and conflict management techniques<br>• Can be costly and unrealistic with a globally dispersed population |
| **Print** | • Improves portability of message for future reference<br>• Effectively supports person-to-person communications<br>• Facilitates mass distribution | • Increases cost of preparation (time and materials)<br>• May limit timeliness of messages<br>• Limits ability to tailor language and messages<br>• Limits ability to convey empathy<br>• Supports one-way communication<br>• Increases potential for filtering/ screening |
| **Electronic** | • Facilitates rapid, broad distribution<br>• Reduces potential for filtering or screening<br>• Supports some two-way communication<br>• Facilitates repetitive delivery<br>• Supports visually stimulating presentation of messages<br>• Permits easy sharing and storage by end users | • May require changes in technology to support group-wide distribution of some of the media<br>• Limits ability to convey empathy<br>• Video requires significant time and cost to produce<br>• Can be easily overshadowed by large volume of electronic communications |

**Step 3.2 Establish the actual message analysis**

Over the course of the project, different messages and pieces of information will need to be shared with various stakeholder groups inside and outside of the organization.

The message analysis identifies *which* key messages need to be disseminated to the various stakeholder groups and *when* these messages should be disseminated. The message analysis is then incorporate with the media analysis and stakeholder analysis to determine *how* key messages will be delivered to *which* groups of individuals and when these messages will be delivered. Here are the Key and Supporting Messages that were identified for (**Project Name**).

*Complete the Key Messages and Supporting Messages for your Communication Strategy and Plan. For definitions of Key Messages see pages 163-165.*

*We recommend identifying no more than 5 to 6 key messages and 3 to 5 secondary messages.*

*Use the Key Messages form in the Communication Tool Kit Workbook to identify your key and supporting messages. The link to Workbook is on page 159. After completion, copy your major key and supporting messages to these bullet points below.*

**Key Messages** *(Enter the key messages below.)*

- …
- …
- …

**Supporting Messages** *(Insert your supporting messages below.)*

- …
- …
- …

**Step 3.3 Validation and approval**

*Upon completion of Step 3, go to the link on page 168, (Project Name) Validation and Approval Process. doc. Use the checklist for Step 3 and send your document for validation and approval before proceeding to Step 4.*

*Complete the Validation Log at the end of the document. Upon return and approval of your document, proceed to Step 4.*

**Step 4: Develop communication plan**

**Step 4.1 Develop communication plan**

To create the communication plan, review all existing documents, the project workplans as well as documentation regarding project milestones. The series of detailed messages that need to be delivered to the organization can be grouped into themes or activities. These themes are summarized in the **(Project Name)** communication plan template, along with advice on how to determine the frequency of these messages.

*The Communication Plan is included in the Communication Tool Kit Workbook. The link to Workbook is on page 159.*

Complete the following columns on that tab:

- **Project Name:** If you are entering data for multiple projects enter it here. If not, this column can be deleted.
- **Event/Theme:** Enter the different events and/or themes of your communication plan.
- **To be completed by:** Enter the date by which each event/theme communication message must be sent.
- **Business Group:** Select the business group to whom you are communicating.
- **Audience:** Your audience will have carried over from the Audience Analysis. Use the drop-down menu to select the audience to whom you are targeting each communication.
- **Media Channel:** Your preferred channels will have carried over from the Media Checklist. Use the drop- down menu to select the ones that will apply.
- **Key Messages:** Your key messages will have carried over from your key messages tab. Use the drop-down menu to select which messages you want to insert.
- **Supporting Messages:** Use the drop-down menu to select the messages you want to insert.
- **Accountability:** Insert who will have the accountability of communicating each of the event/themes of the communication plan.
- **Status:** Use the drop-down menu to identify the completion status of each event/theme identified in your communication plan.

**Step 4.2 Validation and approval**

*Upon completion of Step 4, go to the link on page 168, (Project Name) Validation and Approval Process. doc. Use the checklist for Step 4 and send your document for validation and approval before proceeding to Step 5.*

*Complete the Validation Log at the end of the document. Upon return and approval of your document, proceed to Step 5.*

### Step 5: Collect feedback

### Step 5.1 Collect feedback

#### Collecting feedback on communication performance and effectiveness

The communication plan is designed to achieve the communication objectives defined for the project. However, there is a need to be proactive in measuring performance against objectives.

Key reasons to collect feedback include:

- Promoting two-way communication
- Engaging stakeholders in communications and the project
- Monitoring the effectiveness of communications
- Capturing information to modify the project communication plan to meet the desired communication objectives

Mechanisms to collect feedback to measure the performance can be both formal and informal.

#### Informal evaluation mechanisms

A variety of informal mechanisms can be used to measure the effectiveness of communication, such as:

- The questions asked during typical project meetings
- The questions submitted to a project e-mail box or eRoom
- Questions raised during the person-to-person meetings
- Standing team meetings
- Town Hall sessions

#### Formal evaluation mechanisms

A variety of formal mechanisms can be set up and used to measure the effectiveness of communication, such as:

- Electronic feedback survey
- Participant feedback survey (print)
- Face-to-face exchanges

**Feedback mechanisms**

*The "Feedback Checklist" is included in the Communication Tool Kit Workbook. The link to the Workbook is page 159.*

*Choose from the existing list which feedback mechanisms (means of collecting feedback) the project will use to evaluate the effectiveness of the communications.*

- **Feedback Mechanism:** This will carry over automatically from the Feedback Checklist
- **Purpose:** What the feedback needs to accomplish or provide feedback on
- **Frequency:** When and how frequently feedback will be collected
- **To be completed by:** Enter the date by which each feedback mechanism must be completed
- **Accountability:** Enter who be accountable for each feedback mechanism

Frequently surveying stakeholders and revising the plan midstream to address feedback will better position the project to meet its overall communication objectives by continuously improving the communication efforts.

**(Project Name)** will be using the following feedback mechanisms **(enter each mechanism selected for use, an example is provided on the next page)**.

**Example:**

*The bulk of the formal feedback collection will be done through surveys. We will distribute electronic surveys at regular intervals e.g. November, January, March and May. The surveys will include questions that specifically address our communication objectives. For example, one of our objectives is to reduce fear, uncertainty, and rumours about the newly implemented technology. Therefore, one question on the survey will read:*

*"On a scale of 1 to 7, how well have project communications helped reduce the fear, uncertainty and rumours related to this implementation?"*

*We will also solicit feedback from stakeholders after key person-to-person meetings, such as the communication road show and sponsorship meetings. These feedback mechanisms will take the form of printed feedback forms and will help us determine if we have met the defined objectives for the person-to-person communication sessions.*

### Step 5.2 Validation and approval

*Upon completion of Step 5, go to the link on page 168, (Project Name) Validation and Approval Process. doc. Use the checklist for Step 5 and send your document for validation and approval.*

*Complete the Validation Log at the end of the document.*

### Appendices

### Communication Took Kit Workbook

The Communication Tool Kit Workbook consists of an Excel spreadsheet with multiple tabs, each tab representing one of the worksheets below:

- Version Control
- Instructions
- Help
- Stakeholder Checklist
- Stakeholder Profile
- Stakeholder Matrix
- Audience Analysis
- Media Checklist
- Key Messages
- Message and Media Analysis
- Communication Plan
- Feedback Checklist
- Communication Feedback

*Please download the "Communication Tool Kit Workbook" at http://www.hkiod.com/eng/publication_highlight.asp. Complete the Version Control tab and save your document under your project name. Go to the Instructions tab and print the instructions to help you as you complete the Communication Strategy and Plan document and the individual worksheets in the Workbook.*

### Communication strategy and plan

### Step 1 – Principles and objectives

### SMART objectives

Most managers know what the acronym SMART means in relation to setting objectives. Very few of them can actually write good objectives that comply with all the criteria. Clarifying what SMART means in precise terms really helps managers understand and produce good effective objectives.

### Specific

Specific in the context of developing objectives means that an observable action, behaviour or achievement is described which is also linked to a rate, number, percentage or frequency. This latter point is extremely important-to illustrate. “Answer the phone quickly” can be said to be a precise description of behaviour, you can clearly see whether someone answers the phone or not, but there is no rate, number, percentage or frequency linked to it. So, if stated, ‘Answer the phone within 3 rings’ a rate has been added and the behaviour is now much more specific.

Summary: Is there a description of a precise or specific behaviour/outcome that is linked to a rate, number, percentage or frequency?

### Measurable

This is very simple. A system, method or procedure has to exist which allows the tracking and recording of the behaviour or action upon which the objective is focused. Setting an objective that requires phone calls to be answered in three rings is fine, provided a system exists which measures whether this is actually being achieved. If none exist the manager must be prepared to set time aside to actually monitor the response rates to incoming phone calls. The only other alternative is to get the person with whom the objectives are being set to measure their own progress. In some cases and situations, it may be acceptable to do this, in others maybe not. Use common sense.

Summary: Is there a reliable system in place to measure progress towards the achievement of the objective?

### Achievable

The objectives that are set with people need to be capable of being reached, put most basically; there is a likelihood of success but that does not mean easy or simple. The objectives need to be stretching and agreed by the parties involved. Setting targets that are plainly ridiculous does not motivate people; it merely confirms their opinion of you as an idiot. They will apply no energy or enthusiasm to a task that is futile. Consider sending a group of footballers out to play a game having told them the final score already, and they’ve lost! What’s the point? So don’t do it. (Some people feel that Agreed should stand for the definition of A in SMART. But as this relates to the process of communicating and deciding the objective rather than a definition of the content it seems out of context in relation to the rest of the criteria and consequently not used. However, objectives should indeed be agreed between involved participants rather than enforced.)

Summary: With a reasonable amount of effort and application can the objective be achieved?

**SMART objectives (cont'd)**

**Relevant**

This means two things: that the goal or target being set with the individual is something they can actually impact upon or change and secondly it is also important to the organization. Example: Telling the cleaners that they 'have to increase market share over the next financial quarter' is not actually something they can do anything about—it's not relevant to them. However, asking them to reduce expenditure on cleaning materials by £50 over the next three months is entirely relevant to them. It's what they spend their budget on every day. As to whether it's relevant to what the organization is trying to achieve, the manager has to decide this by considering the wider picture.

Summary: Can the people with whom the objective is set make an impact on the situation? Do they have the necessary knowledge, authority and skill?

**Time-bound**

This is probably the simplest of the lot. In the objective, there has to be a date (Day/Month/Year) for when the task has to be started (if it's ongoing) and/or completed (if it's short term or project related).

Summary: Is there a finish and/or a start date clearly stated or defined? Simply: No date = no good.

The following are examples of objectives that have been improved using SMART criteria:

| Original Objective | Improved objective using SMART criteria |
|---|---|
| Support implementation of ISO 9001 | Develop all departmental instructions and procedures according to ISO 9001 and train all employees in Finance department below VP level (at <Client Location>) by September 15 to successfully pass first ISO 9001 audit to be held in November. |
| Reduce time to process pricing requests | Reduce processing time for pricing request from time to receipt to contract signature from 20 days to 10 days by end of the first quarter. |
| Reduce catalogue by April 12 | Contribute to reduce supplier base by 25% by consolidating all existing parts catalogues into one streamlined online version and implementing new catalogue by fiscal year end in all business units. |
| Develop project management skills | Complete Project Management Institute certification and develop project management skills by leading new Adobe 2456 system project team and implementing system on budget and on schedule in all manufacturing sites by December. |
| Learn Six Sigma methodology | Attend Six Sigma Agent 1 training in the first quarter. Pass certification by end of second quarter. Use appropriate Six Sigma tools to assist Finance Department in implementing new accounts payable system project by year end. |

**Step 2 – Stakeholder and audience analysis**

*You will need to complete your stakeholder profile and audience analysis using the link to the Communication Tool Kit Workbook on page 159.*

**Step 2.1 Identify and group stakeholders**

**Stakeholders are individual groups:**

- Who are Impacted by the change
- Needed to implement change
- That have the ability to provide needed resources/knowledge
- Whose approval is necessary for the change
- Whose sponsorship/ownership will ensure the cooperation of others

**Identify the stakeholders that will influence and\or impact the project. To start this process, ask the following questions:**

- Who are they?
- Where are they located?
- What is their profile?

**Try and put yourself in their shoes or gather information on:**

- What information would they like and need to have?
- What information, competencies, experience and knowledge do they have that may contribute to the success of this project?
- What is their past experience with change? What is their current context (e.g. are they going through other significant changes)?
- How will this project hinder or help them achieve their organizational objectives and career goals?
- What's their current and required level of awareness and understanding of the project?
- What's their current level of buy-in? Are they for, against, or on the fence?
- What is the priority level of this project?

**Step 2.2 – Understand the situation**

The Stakeholder Questionnaire is provided for "setting the stage" (the first step in preparing the text for the interviewee) and the questionnaire itself – which has guideline questions that you can edit and modify as needed for the project.

For, "setting the stage", take the project background, principles and objectives information already completed in this communication strategy document in enter them in the first part of the questionnaire.

*Please download the "Communication Tool Kit Stakeholder" at http://www.hkiod.com/eng/publication_highlight.asp and complete the Stakeholder Questionnaire for each potential stakeholder you have identified and save your document under your project name.*

**Step 2.3 – Stakeholder matrix**

**Approach by quadrant**

- Communication attention will *be focused* on stakeholders in **quadrant I (Enlist as Needed)**. This group has a high degree of influence on the project's success, but experiences a low degree of impact due to the project.

- Communications to stakeholders in **quadrant IV (Keep Informed)** will *keep them abreast* of the changes and next steps. Stakeholders in this group are not impacted by or able to influence the project to any large extent, but ongoing monitoring of these stakeholders is required.

- Stakeholders in **quadrant II (Involve Extensively)** are project advocates. Communication efforts will help these stakeholders be *the nerve centre of the communication process*, in addition to facilitating their internal information needs. These stakeholders are the most important to the project's success, and will consequently require the highest degree of resources and time.

- Stakeholders in **quadrant III (Address Concerns/Needs)** will be updated as needed in order to *keep them involved and prepared* for future communications and actions. These individuals will experience a relatively high degree of impact due to the project; however they have less ability to influence project success.

**Step 3 – Key messages and media analysis**

**Identify key messages**

Now that the stakeholder/audience broken down into bite-sized units that can more easily deal with, list a one-or two sentence message that needs to be communicated to each key audience. These audience-specific messages will come from the overall project objectives that were developed earlier. Remember, a message for a specific audience arises out of the emerging themes that surround the business issue.

A message should further an audience's knowledge, understanding and/or commitment vis-à-vis an issue. Messages improve productivity, help promote "buy-in" to an issue, and explain the rationale behind a decision. Messages help answer the ubiquitous organizational members' question, "What's in it for me?"

Remember, the communication plan must incorporate ways of listening to key audiences as well as of developing messages for them. The plan should include goals that establish, maintain, and develop good relationships with those key stakeholders/audiences. The major reason for having a communication program in the first place is to build and maintain good relationships with key stakeholders/audiences so they can help the project achieve its goals. Rely on mediation, negotiations, and conflict resolution with key stakeholders, not just on getting the right message to the right people through the right channel.

Communication should not be reserved just for the good news or to try to "spin" bad news. There are effective ways to communicate messages with bad news. Matthew Boyle, writing in the February 19, 2001, issue of **Fortune** magazine, offered the following advice for communicating the reduction of perks:

**How to get lean – without being mean**

| | |
|---|---|
| **DO** | Try to scale back perks without eliminating them entirely |
| DON'T | Allow employees to learn about cutbacks through the grapevine |
| **DO** | Ask employees which perks are most important |
| DON'T | Make cuts that affect only lower-level staff |
| **DO** | Explain the cutbacks in a business context that's understandable |
| DON'T | Assume cutting perks is a panacea for other problems |

**SUMMARY**

Include the following things in the message to the key stakeholders/audiences section:

- An audience-specific variation of the main message or emerging theme that surrounds a business issue, a message specifically targeted to this key stakeholder/audience
- Allow for a two-way communication

**Sample key audience message 1**

Notice how the same message theme on the same business issue is communicated with slightly different messages to different audiences/stakeholders:

Audience: Supervisors in the plants where there is a perceived pollution problem
Message: *We've cleaned up our act. Believe it, and help your employees understand our efforts. And stay with us to help us become the environmental good citizens we intend to be.*

Audience: Hourly paid employees in the plants where there is a perceived pollution problem
Message: *We've cleaned up our act because we care about the environment in which you live, work, and bring up your kids. And we want you to stay with us to help us become the environmentally good citizens we intend to be.*

Audience: Key business/civic leaders in cities where we have plants (instead of "general public")
Message: *We live here and bring up our children here too, and we will do whatever it takes to be environmentally good citizens. Help us be good citizens.*

Audience: Trade and industry publications (instead of "media")
Message: *XYZ Corporation has just spent and average of $1.75 million per plant on the most sophisticated pollution control equipment available to this industry. We have corrected any pollution problems.*

Audience: Business unit leaders at headquarters responsible for implementing the new reengineering process
Message: *Employees must know the reasons for reengineering, the step-by-step process and time line, and how it may affect them personally. Plan to use interpersonal means of communication, relying on mediation, negotiation, and conflict resolution to help employee cope.*

Audience: Managers and first-line supervisors in the units targeted for reengineering
Message: *Same as for business leaders, plus: We will meet with you to discuss your concerns and to talk through how you can help your employees to understand the situation.*

Audience: Non-union hourly paid employees in the three units currently targeted for reengineering
Message: *Here are the reasons for reengineering, the step-by-step process and time line, and how it may affect you. What are your concerns that we may act on them?*

**Appendix-Budget**

Have you taken the following into consideration with the project budget?

- Writing/editing/proofing
- Design and layout
- Translation/revision
- Printing
- Marketing/teasers
- Training

In the above-mentioned topics have you taken the following into consideration?

- Time constraints and extra costs
- Internal resources required
- External resources required
- Measurability

**Writing/editing/proofing**

What editing will need to be done to the documents?

- Who is editing the documents?
- If the document has been translated, a comparison between the native language is recommended.
- What are the time constraints in editing these documents?
- Is there a process in place for editing?
- Do we have subject matter experts (SMEs) to edit the documents?

**Suggested references:**

**Writing:** The Corporate Office uses the Country A Press Caps and Spelling, supplemented by the Country A Oxford dictionary.
**Editing and proofing:** A list of common editing and proofing symbols can be provided upon request to internal.communications@<Company X>.com.

**Translation/revision**

Is there any translation requirements associated with this project? If yes, click on the link below for a detailed look at the following:

- Roles and responsibilities
- Procedure
- External translation agencies
- Estimated costs
- Time constraints

Important: Remember to calculate resources and timeline required for all translation in your communication plan.

A form to track the version and production status associated with the translation/revision is provided in the link below http://www.hkiod.com/eng/publication_highlight.asp.

*Review the translation process to help you identify resources, time and budget required. Use the translation/revision control sheet to monitor the translation/revision process. If you plan to use these documents as references for your communication plan, save them under your project name.*

**Printing**

Below are some key considerations to keep in mind.

- Will there be any commercial printing needed for this project?
- Is there a budget for printing?
- Should job be printed in Country A or locally?
- Who will do this printing?
- What are the time constraints with this printing?
- Where is the job to be distributed? Country A or locally?
- When printing in multiple languages consider cost savings in scheduling your print jobs.
- Combine with other print jobs if possible, and print all languages at the same time to save costs.

### Marketing/Teasers

On occasion of new project launches, or when there is a specific marketing need for a project, consider the following:

- Have you discussed the needs/options with Public Affairs?
- Does the project require any marketing teasers?
- If yes, how will they be visually created?
- Is there a budget?
- Who is responsible?
- Languages required?
- Who should distribute and to whom (audience)?
- Whose approval is required for creation? For distribution?
- What are the time constraints in completing?
- Have you incorporated these actions into your communication strategy and timelines?

### Training

Will there be any training required before, during or after your project?

- Is there a budget for training?
- What training is needed?
- Where and how will the training take place?
- Who will do the training and when?
- What is the time constraints needed?
- Opportunity to leverage existing training?
- Opportunity to package training with a related project?

Time constraints should also be taken into consideration when considering any training needed. Contact Human Resources for additional assistance in determining the training needs associated with your project.

### Validation approval process

#### Purpose

Managing the validation process is a key element in defining the quality of the Communication strategy and all its relevant documents.

The validation and approval process assures that:

- Public Affairs is able to validate, provide assistance and guidance at the beginning of the procedure and project
- Principles, objectives and key messages are consistent with<Company X>'s vision and project initiatives
- Review of the communication strategy documents are done in a timely manner
- Review points are consistent
- Review and edits are performed by the proper person

The success of the validation and approval process requires that all parties—reviewers as well as project managers and/or communication teams—have a clear understanding of the purpose, requirements and scope of each validation.

The validation and approval process with the reviewer checklist is attached in the link below.

Please download at http://www.hkiod.com/eng/publication_highlight.asp

*Open this link and read the validation and approval process and then use the validation and approval checklists to send your documents for validation after each step of your communication strategy.*

**Roles and responsibilities**

To realize the communication strategy and execute the communication plan that supports the strategy, individuals from different parts of the organization will need to play key roles in the communication effort.

Specific roles and responsibilities will need to be identified for key team members. The following link is to be used as guidelines only, you can modify and update as needed.

Please download at http://www.hkiod.com/eng/publication_highlight.asp

*Open this link to find sample roles and responsibilities for project team members in regards to communication strategies and plans. Modify and use as needed.*

**Communication tips**

***Verbal Communication***

- **Slowdown your pace-**Articulate; don't use slang, abbreviations or jargons.
- **Repetitions-**Repeat key messages with different words and different media.
- **Use simple sentences-**Avoid long and complex sentences.

***Non-verbal Communication***

- **Visual material-**When possible, **use** visual aids: pictures, graphs, tables, slides, etc.
- **Gesture-**Multiply hand gestures and body language to express words' meaning.
- **Demonstration-**When possible, make practical demonstrations.
- **Pause-**Allow for **frequent** pauses.
- **Summary-**After **each** verbal presentation, distribute a summary document to all participants.

***Audience's Reactions***

- **Silence-**Allow **silence**. If your audience is not familiar with your language, participants need more time to think and translate.
- **Misinterpretation-**Don't interpret your audience's lack of understanding or inability to rephrase clearly as lack of interest or expertise.
- **Differences-**Presume that there are more differences than similarities between you and your audience.

***Comprehension***

- **Comprehension-**Don't assume that your audience understands you. Start with the hypothesis that they don't understand.
- **Verify their level of comprehension-**Don't only ask if your audience understands you, invite them to paraphrase and use their own words to summarize. Ask them what they understand.

***Process***

- **Breaks-**Plan for frequent breaks to allow participants to relax. Communicating in a second language that participants don't master can be exhausting.
- **Segment content-**Segment content in short modules.
- **Allocate a time buffer-**It often takes more time with an audience with heterogeneous language skills.

***Motivation***

- **Reinforcement-**Encourage your audience through various verbal and non-verbal cues to exchange in their own or second language or have a communicator/translator that could help clarify.
- **Participation-**Ensure participation of every member of the audience.

***Guidelines for effective communication***

- **Know your stakeholders—know their agenda**
  - Who are they? Where are they located? What is their profile? What communication media available to them has been successful in the past?
  - What information would they like and need to have?
  - What information, competencies, experience and knowledge do they have that may contribute to the success of the project?
  - What is their past experience with change? What is their current context (e.g. are they going through other significant changes)?
  - How will this project hinder or help them achieve their organizational objectives and career goals?
  - What's their current and required level of awareness and understanding of the project?
  - What's their current level of buy-in? Are they for, against or on the fence?
  - What is the priority level of this project?
- **Know yourself and your agenda**
  - What is your communication strategy and plan?
  - Who is responsible for the deliverables in your communication plan?
  - What are the key messages?
  - What are the guiding principles and objectives?
  - Who is critical to the success of the project?

- **Adjust your communications (message and media) to your audience**
  - "One size doesn't fit all" when it comes to communication. You need to understand the different profiles of your various stakeholders and adjust the content and delivery to meet specific needs.
- **Keep it as simple as you can/make it timely and flowing**
- Don't try to communicate too much information at once. This guideline is especially important if your documentation will be translated.
  - Avoid acronyms and jargon
  - If you can, test out your messages with people outside of your project team or of the organization

**Share the thinking process with key stakeholders at every step**

  - Share the thinking, not just the conclusion
- **Align words and behaviours**
  - Your behaviour communicates more than your words
  - "Silence" is often communicating what is not said, it is as important as what is said
  - The key is alignment with other messages and actions
  - If there are several other people working with you on the project—for example, if your project has more than one sponsor—make sure their words and behaviours are aligned
- **Be an active listener**
  - Stimulate communication by asking open-ended questions and making eye contact
  - Paraphrase back to the speaker what you heard to ensure a clear understanding
  - Create a positive atmosphere for constructive exchange (choose appropriate place and time)
- **Build on face-to-face**
  - In order to mediate difficult or complex topics, face-to-face communication is preferred
  - Immediate superiors are employees' preferred source of information
- **Engage people in the process**
  - Showing is more powerful than telling
  - Engaging is more powerful than telling
  - Effective communication is about building relationships
  - Relationships determine meaning
  - Remember that communication is a two-way continuous process. Communicating allows people to contribute and get involved. Incorporating key players in the process increases the chance of buy-in and commitment

**Document management**

Project status, completed issue reporting forms and all communication plan versions should be stored and easily accessible.

**Document naming**

Apply a standardized naming convention to your documents. Project managers are encouraged to follow these guidelines.

The naming convention is as follows:

| **<Project Name>** | **-<Document Name>** | **-<Version>** | **<Initials>** | **<Date Updated>** |
|---|---|---|---|---|
| Project Name. | Standard forms have specific naming: weekly status, issue reporting, communication plan, etc. | One letter and numbers in the format x9.9. Possible letters are D for Drafts and A for Approved documents | Initials of the author who did the last modification | Date of the last update in a YYYYMMDD format |

**Examples:**
*Public Affairs Communication Tool Kit – Communication Strategy and Plan – D1.0 AC 20041001.doc*
*Public Affairs Communication Tool Kit – Communication Strategy and Plan – A9.0 AC 20041208.doc*

**ISO 639 Standard Language Codes** should be used to manage documents that will be produced in multiple languages. These two-digit codes are provided in the Translation Control document, which is included as a link on page 166. The codes should be put after the version number as shown below.

**Examples:**
*Public Affairs Communication Tool Kit – Communication Strategy and Plan en – D1.0 AC 20041001.doc*
*Public Affairs Communication Tool Kit – Communication Strategy and Plan fr – D1.0 AC 20041001.doc*

**Acknowledgements**

The following documents were referenced for this tool kit:

- <Company X> Change Leadership, Tools and Techniques Manual, August 2001
- IABC International Association of Business Communicators – Second Edition The Communication Plan The Heart of Strategic Communication – Lester R. Potter, ABC
- SMART Objectives based on the SMART Objectives by Garry Platt, Senior Consultant at Woodland Grange
- <Company X> Communication Planning Process – Communication BOX
- Comportement Organisationnel: une approche multiculturelle – by Nancy I. Adler, les Editions Reynald Goulet, Inc. (1994)

## 5. Further Readings/References


- Lyn Smith and Pamela Mounter. “Effective Internal Communication.” 2005.
- Geraldine E. Hynes. “Manergerial Communication: Strategies and Applications.” 2007
- Paul A Argenti. “Corporate Communication.” 2005.

The Hong Kong Institute of Directors

Corporate Governance Toolkit

# Attract Capital and Debt Finance

Reference and page number in “Guidelines on corporate Governance for SMEs in Hong Kong”

| **Reference number** | **Page** | **Title → subtitle in Guidelines** |
|---|---|---|
| 1.3.3 | 10 | The concept of corporate governance and its importance → Small and medium enterprises in Hong Kong |
| 2.1.10 (c) | 15 | What governance practices do Hong Kong SMEs need? → The need for good governance |
| 2.2.1 | 16 | What governance practices do Hong Kong SMEs need? → Category 1 |
| 2.3.1 | 18 | What governance practices do Hong Kong SMEs need? → Category 2 |
| 2.3.3 (d) | 21 | What governance practices do Hong Kong SMEs need? → Category 2 |
| 2.4.1 | 22 | What governance practices do Hong Kong SMEs need? → Category 3 |
| 3.6.1 | 45 | The special issue with family owned companies → Capital for growth and loss of control |

Management practice cycle (“Guidelines on corporate Governance for SMEs in Hong Kong” page 8)

| **Cycle Number** | **Management practice cycle** |
|---|---|
| 1 | Planning |
| 2 | Key Performance Indicators (KPIs) |

## 1. Overview

Attracting, selecting, and managing financing options is challenging, even for seasoned managers. The key to getting the best deal is preparation—two thirds of the financing process occurs before a single investor or banker is contacted. Companies must plan their finance strategies and submit to a harsh reality check before engaging potential investors or bankers.

As demand for a company's products or services increases, its resources, including people, production capacity, and cash are strained. To sustain and enhance growth, companies want to pursue new ideas, market opportunities and value-creating projects, but they often lack the means to do so while continuing to meet current demand. To move past the limitations of existing resources, companies need to seek outside funding. Attracting capital and selecting and managing financing options while staying in control of the financing process, however, is complex and time-consuming, even for the most seasoned management team.

Companies tend to put all their resources into meeting their existing demands. This is why the idea of pulling valuable resources and management attention away from market-focused activity to execute financing can seem unfathomable. The individuals with the knowledge and skills required to raise funds are often central in running the business and can't afford to shift their attention away from critical operational issues.

Even in a bull market, companies face stiff competition for access to a limited pool of investment funds and loans. Investors and bankers expect a company to demonstrate that it possesses a significant growth opportunity and that it has a sustainable competitive advantage that will lead to measurable and substantial returns.

Potential bankers demand certainty from companies and want to know precisely what companies expect to achieve and how they plan to execute on their strategy. Investors exact premiums in the form of high interest rates or equity requirements when companies cannot mitigate risk with detailed strategies, tactics, or contingency plans.

## 2. What You Can Do

The first step before talking to investors or bankers is for a company's management team to plan a finance strategy that defines how much money the company needs, when it's needed, where the money will come from, how it will be used, and what the company expects from investors or bankers. Companies should prepare for discussions with investors or bankers by subjecting their business plans to thorough and rigorous reality checks. Companies must then engage multiple potential investors or bankers and focus their energies until they have successfully negotiated the terms they desire.

**2.1. Plan a finance strategy.** To stay in control of the funding process, companies need to prepare solid finance strategies well in advance of negotiations. Knowing what is expected from the funding process will focus a company on the most appropriate financing options and prepare and position them for investor engagements. For the planning process, please refer to illustration 4.1 for detail.

- **Take stock.** Before a detailed finance strategy is mapped out, companies need to go through an internal information gathering and rationalization process in order to gain a complete picture of their current operations. Every area of the business, including non-revenue producing units, must provide operational data, market assessments, and current financials. Managers must reconcile the information they provide with the company's long-term vision and strategy so that every aspect of the business is assessed and understood in a broader context. Taking stock will force companies to reflect on the factors that drove their current success and the extent to which these reflect expectations and assumptions. This process will also help identify areas of the strategy—financial, operational, or market-related—where companies are constrained and need help to succeed.

- **Build the strategic plan.** Once all the requisite information has been collected and validated, companies need to develop a strategic plan that lays out in precise detail what they intend to accomplish, and how they plan to accomplish it. The strategic plan should begin by clearly articulating the company's vision, goals, and direction, including a clear statement of focus and a unique market proposition, discuss each area of the company's operations to establish a concrete connection between the costs the company incurs and the revenues it forecasts. The plan needs to describe outcomes, obstacles, contingencies, and future needs. Outcomes can be portrayed in several ways, but they must be measured because investors need this information to calculate the return on their investment. The strategic plan should provide a financial picture of the company, which includes pro forma statements for up to five years as well as several years' historical results. This will justify the need for external financing by outlining how much capital is required, indicating when it is needed.

- **Identify investment options.** Once a company has a strategic plan in place that establishes where they are, where they are going, and what they need to get there, they can start to make choices about the types of financing they want to pursue. A company's growth stage is the key determinant of what type of capital is available, but within each stage there are a number of options. For detail, please refer to illustration 4.2. To select the preferred source, companies need to consider several factors. These include the company's appetite for dilution of ownership and control, the need for value-added services from the investor beyond capital, and future financing requirements.

**2.2. Prepare for the funding process.** With the strategic plan complete and a general investment direction chosen, companies can begin to prepare for the funding process by putting themselves through the same rigorous review they will face once investors or bankers are engaged. Management must assume the perspective of potential investors or bankers who will investigate and test a company's ability to deliver the required return on investment—this is known as the due diligence process. In this process, management must highlight the current organizational structure, prove their business model, and validate the financial package that will be provided to investors. For detail, please refer to Illustration 4.3.

- **Highlight the organizational structure.** The single biggest factor for an investor or banker in determining whether a company can deliver on its strategic plan is the perceived quality of the management team. For a company to prove that their executives are focused on value creation, they must provide evidence that their team is comprised of individuals who have the necessary vision, desire, and experience to create success. Companies also need to determine how their current management teams will have to evolve to meet future requirements. If a current team's capabilities are limited, they should not hide the fact that new executives will be required. A company's structure should be articulated with well-defined accountability and responsibilities in order to alleviate concerns about their ability to execute their business model. If a company is relatively young, or looking for a long-term investment partner, they must also be able to illustrate how they will evolve over time. The management team should prepare prospective organizational charts that depict the structure one to three years in the future.

- **Prove the business model.** The quality of a company's market opportunity and business model is what investors will use to determine franchise value—the return on investment the company will generate through its sustainable competitive advantage. Companies must, therefore, be able to show investors or bankers that they are focused on a sizable, specific, attractive, and growing market. A company's business model must outline a sustainable competitive advantage that will generate and preserve demand for its products and services over time. The best way for a company to show investors that their business model is sound is by making customers available to speak directly to serious investors. For early stage companies with limited market presence, references from strategic partners, suppliers, and research analysts should also be provided. If there are investors or bankers with the resources to participate in this round of funding, their commitment is absolutely necessary. Any hesitancy on the part of current stakeholders is a serious deterrent to potential investors.

- **Validate the financial package.** The financial package provided to investors or bankers will go through intense scrutiny. Companies must be prepared to support historical and projected cash flow statements, income statements, and balance sheets with a level of detail beyond that included in audited financial statements and accompanying notes. A sales model that breaks down revenue by product, service, geography, and salesperson should be built from the ground up. This will help justify a company's market penetration assumptions. The cost model should also be presented in similar detail and in the same format. It is vital to list all sales and expense assumptions and to justify them with historical data where available. The information in the company's financials must support the overall strategic plan: the sales department's expansion needs to keep pace with revenue projections and capital expenditures must reflect future production capabilities. When preparing financials, companies must consider the time frame within which the targeted investors will want to liquidate their holdings. Projected debt repayments must be supported within cash-flow projections. For equity investors, their exit will require more supporting data. A good tool for this purpose is a table listing a company's future value relative to other companies similar in size, market, or industry. For equity investors, this table needs to be supported with a list of comparable transactions, such as recently announced mergers, acquisitions, or initial public offerings, which support a company's assertion that an attractive liquidity event is possible.

**2.3. Engage the investors/bankers.** By dedicating significant time and effort to proactive planning and preparation, companies can successfully control and leverage the process of engaging the investment community. They must, however, maintain a sharp focus on their ultimate objectives.

- **Shop a deal selectively.** Companies need to speak with several investors or bankers in order to create a competitive setting for their transaction and build their comprehension of the investment landscape. They should bear in mind, however, that members of the investment community are in contact with one another. Pitching a deal indiscriminately can tarnish a company's reputation by casting doubt on their intentions or even their viability. Companies should be cautious about the number of people they approach in order to balance the need to generate demand for the deal with their ultimate goal of establishing a relationship with the most appropriate investor. This approach will also help manage the expectations of a company's stakeholders (employees, owners, and directors) by educating them about what is attainable and realistic. Where there is no existing relationship with an investor or banker that a company wishes to pursue, a referral from a trusted third party will be required. Current investors, board members, advisors, accountants, consultants, lawyers, and other strategic partners may all be consulted for this purpose. To prepare for an initial meeting, companies need to practice their presentation until they are confident that they can deliver their material and answer any questions that may arise. Presentations should be tailored to the specific investor. Venture capitalists will want the focus to be on a company's management team, while a mezzanine-stage investor will be concerned with a company's historical performance and financial health.

- **Negotiate the details.** Negotiations implicitly begin in a first meeting, eventually narrowing the pool of candidates. As companies move to second- and third-round meetings, the field of potential partners is reduced to a group that has expressed serious interest and a desire to strike the appropriate balance between providing funds and allowing the company to maintain control and ownership at a fair and justified level. By the third or fourth meeting, intense negotiations will begin. The goal here is to extract a term sheet that outlines the major elements of the deal (also known as a Letter of Intent "LOI" or Memorandum of Understanding "MOU") from at least two of the investors or bankers still in negotiations. In choosing the appropriate term sheet, companies should focus on the deal structure and how the financing will impact their ability to execute their strategic plan. The pros and cons of each deal must be weighed and companies should also keep in mind that, in order to achieve their strategic priorities, they will have to make some compromises. For example, the accountability requirements in a debt financing with restrictive covenants might be more prohibitive and "costly" to future growth than the control given to an equity investor who demands a seat on the board and approval rights on a company's annual strategic plan. At the end of the day, negotiations will succeed or fail based on how well the investor's perception of risk and reward has been managed. Future financing and the impact it will have on the investor need to be anticipated. Concerns will include the preferential ranking of their financing instrument (debt or equity) and the potential dilution of their ownership position (equity only) caused by future investors.

- **Close, collect, and reflect.** Deals can be radically altered, or fall apart altogether, as markets change, companies fortunes evolve, and investor's interests wane. Companies need to be proactive, providing answers to questions they anticipate investors will ask. This can shorten the time to closing and reduce the probability that unforeseen risk factors will negatively influence the deal. To ensure success, companies must stay involved with the process to the end, constantly communicating with lawyers and maintaining momentum by keeping investors engaged and focused on the deal. Throughout the process, maintain a good working relationship with all the investors you have approached. As investments are finalized, companies should undertake thorough evaluations of the investment process. This evaluation will help identify what went well and what, in retrospect, could have been done more effectively. It will also ensure that the necessary structure and processes are in place to keep new investors engaged. This will help maintain the positive relationship that secured the deal and will increase the likelihood that the investor may be contacted for future requirements.

## 3. Benefits/Limitations

**3.1. Benefits.** There are several benefits of attracting capital and debt finance in an efficient manner. It increases the attractiveness of the company to potential investors; subsequently it lowers the cost of capital and increases profits as well as the value of the stock of the company. Additionally, it provides confidence to the stockholders and the morale of the employees is boosted.

**3.2. Limitations.** The limitation of attracting capital and subsequently obtaining the funds arises basically on the risk that the company will not be able to follow the proposal it provided to the investors (or its stockholders) and will not be able to meet its financial obligations. Even if a company possesses a team of brilliant managers and the market conditions are perfect for the company to implement a project, unexpected events may arise and the company may find itself in an undesirable financial situation. Subsequently, it may need to file for bankruptcy for not being able to meet its financial obligations. It is important to understand that there are always risks involved in developing new projects, so it is critical that the company asks itself whether it really needs outside funding before it actually requests them.

## 4. Tool, Templates and Illustrations

**Illustration 4.1: The Planning Process**

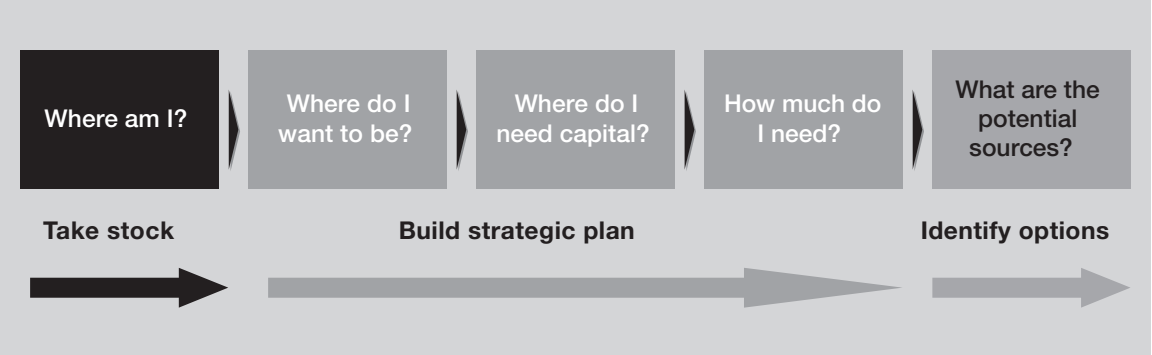

**Illustration 4.2: Funding Lifecycle**

| | Start-up | | Growth Phase | | |
|---|---|---|---|---|---|
| **Primary company activities** | • Product concept<br>• Market analysis | • Form company<br>• Develop product<br>• Test production<br>• Develop marketing concept | • Go to market | • Sales growth | • Improvement of production and marketing systems; exploitation of market potential; entry into new market areas |
| **Investment Phases** | **Seed**<br>Start-up capital is used for feasibility studies, market testing & business formation. | **Start-up**<br>A company concept is validated with a prototype, and testing confirms that a market exists for the proposed product or services. | **Growth**<br>A company begins to generate revenues from its product of service, but it typically operates at a loss as it invests in its own growth and distinguishes itself from competitors. | **Expansion**<br>A company begins to generate free cash flow and positive net income, which is retained to fuel growth. | **Mezzanine**<br>Companies are fully operational and generate increasing revenues, yet they still need capital to expand the company further and retain its momentum. |
| **Sources of Financing** | • Owners<br>• Family / friends | • Governments / supplier<br>• Strategic partners<br>• Early-stage equity funds | • Lessors<br>• Customers<br>• Trade | • Banks<br>• Venture capital<br>• Asset-backed lending (ABLs) | • Institutional investors<br>• Public markets<br>• Securitization |

### Illustration 4.3: Investor's Litmus Test

**Organization structure**
- Does management have the necessary vision and experience to execute their strategy successfully?
- Can this company attract and retain key employees?

**Business model**
- Is the company focused on a sizable, specific, attractive, and growing market?
- Does the company have real customers?
- Do existing stakeholders support the company?

**Financial package**
- Is the potential return on investment worth my time, effort and resources?
- Are revenue and cost assumptions supported with sufficient detail?
- Will I be able to exit this investment in a timely manner?

### Tool 4.4: An Executive's Diagnostics

Planning your finance strategy, preparing for the funding process, and engaging investors are the three key steps in the process of attracting capital. The following 20 questions will assist your organization in ensuring that key aspects of your financing initiative have been articulated and addressed.

| | | Yes | Somewhat | No |
|---|---|---|---|---|
| ***Plan your finance strategy*** | | | | |
| 1 | Have you gone through an internal information gathering and rationalization process that gives you a complete picture of your company's current operations? | | | |
| 2 | Is the information about the company's current operations reconciled with the company's long-term vision and strategy such that every business is assessed and understood in a broader context? | | | |
| 3 | Have you developed a strategic plan that lays out in precise detail what the company intends to accomplish and how it plans to accomplish it? | | | |
| 4 | Has your management team examined, based on your strategic plan, whether: 1) external financing is necessary; 2) all of the proceeds of this financing can be used productively; and 3) the amount of funding required can actually be obtained? | | | |
| 5 | Have you identified the investment options available to your company? | | | |

| | | Yes | Somewhat | No |
|---|---|---|---|---|
| 6 | To select your preferred source of financing, have you considered factors such as your company's appetite for dilution of ownership and control, the need for value-added services from the investor beyond capital and future financing requirements? | | | |
| ***Prepare for the funding process*** | | | | |
| 7 | Can you demonstrate that your management team is comprised of driven individuals who have the necessary vision, skills, and experience to create success? | | | |
| 8 | Have you articulated your company's structure with well-defined accountability and responsibilities in order to allay concerns about your ability to execute the funding process? | | | |
| 9 | Have you developed a business model outlines a sustainable competitive advantage to generate and preserve demand for your company's products or services over time? | | | |
| 10 | Have you detailed your company's product and service road map, including the R&D plan, identification of key suppliers and the post-sales support that will be provided? | | | |
| 11 | Have you detailed the competitive landscape, including current market share, SWOT (strengths, weaknesses, opportunities, threats) analysis and estimated lead-time over the competition? | | | |
| 12 | Have you developed a list of current and potential "reference-able" customers? | | | |
| 13 | Are you prepared to support the financial package provided to investors with historical and projected cash flow statements, income statements and balance sheets that have more detail than contained in your audited financial statements? | | | |
| 14 | Have you considered the time frame within which your targeted investors will want to liquidate their holdings, and have you prepared a financial analysis of exit opportunities (equity investor) or repayment schedules (debt investor)? | | | |
| ***Engage the investors*** | | | | |
| 15 | Have you approached five or more investors before negotiating a deal? | | | |
| 16 | Have you asked your current investors, board members, advisors, accountants, consultants, lawyers, and other strategic partners to refer you to potential investors? | | | |
| 17 | Before your initial meeting with potential investors, do you practice your pitch until you are confident that you can deliver your material and answer any questions that may arise? | | | |

| | | Yes | Somewhat | No |
|---|---|---|---|---|
| 18 | Do you anticipate future financing and the impact it will have on the investor, such as preferential ranking of their financing instrument and potential dilution of their ownership position? | | | |
| 19 | After the investment is finalized, do you undertake a thorough evaluation of the investment process so that the experience can be leveraged for future financing? | | | |
| 20 | Do you ensure that the necessary structure and processes are in place to keep your new investor engaged to maintain a positive relationship and increase the chance of future financing? | | | |

*If more than 75% of your answers (16 of 20) are "Yes," then your company is addressing the challenge of attracting capital. If 50 to 75% of your answers (10 to 15) are "Yes" or "Somewhat," there is more work to be done in order to attract capital. If less than 50% of your answers are either "Yes" or "Somewhat," your company needs to re-evaluate its approach toward attracting capital.*

| | | |
|---|---|---|
| ***Re-evaluate →*** ***0 - 50% →*** | ***→ Needs more work →*** ***→ 50 - 75% →*** | ***→ Ready*** ***→ 75 - 100%*** |

## 5. Further Readings/References

- "Growth, the Executive Series – Attracting Capital: Selecting and managing your options." Deloitte Publication.
  http://www.deloitte.com/dtt/research/0,1015,sid%253D7109%2526cid%253D132628,00.html

# The Hong Kong Institute of Directors

# Corporate Governance Toolkit

# Develop Financial Statements

Reference and page number in “Guidelines on corporate Governance for SMEs in Hong Kong”

| **Reference number** | **Page** | **Title → subtitle in Guidelines** |
|---|---|---|
| 2.2.2 (a) | 17 | What governance practices do Hong Kong SMEs need? → Category 1 |
| 2.2.3 | 18 | What governance practices do Hong Kong SMEs need? → Category 1 |
| 4.7.2 (e) | 53 | Management Practice Guidelines → Controlling |

Management practice cycle (“Guidelines on corporate Governance for SMEs in Hong Kong” page 8)

| **Cycle Number** | **Management practice cycle** |
|---|---|
| 1 | Planning |
| 2 | KPIs |
| 6 | Controlling |

## 1. Overview

The purpose of financial statements is to provide information about the financial position, performance and changes in financial position of a company that is useful to users of such information. Financial statements show the results of management's stewardship of and accountability of the resources entrusted to it. They should also provide an accurate description of the business and non-business activities of a company such as what it own, what it owe, how much revenue was generated, what obligations were paid and what resources remain. Users of financial statements generally include present and potential investors, employees, lenders, suppliers, customers and governments.

SMEs in Hong Kong should note that The Hong Kong Institute of Certified Public Accountants (HKICPA) has recently issued standards of accounting practices-the SME Financial Reporting Framework (SME-FRF) and Financial Reporting Standard (SME-FRS). For those company that qualify under the SME-FRF to prepare and present its financial statements in accordance with the SME-FRS, a complete set of separate financial statements for the entity includes 1) Balance Sheet; 2) Income Statement; and 3) accounting policies and explanatory notes should be prepared. For details, please refer to the HKICPA website.

## 2. What You Can Do

**2.1. Balance Sheet.** Balance sheet (or statement of financial position) provides a concise snapshot of a company's financial position. It shows owned assets (economic resources), liabilities (economic obligations) and owners' equity (the residual claim of owners). Assets must be in balance with liabilities plus owners' equity. Moreover, the company should determine, based on the nature of its operations, whether or not to present current and non-current assets and current and non-current liabilities as separate classifications on the face of the balance sheet.

- **Assets.** Assets are resources controlled by the company as a result of past events and from which future economic benefits are expected to flow to the company.
  - *Current assets* are those assets that satisfy any of the following criteria:
    - It is expected to be realized, or is intended for sale or consumption, in the entity's normal operating cycle;
    - It is held primarily for the purpose of being traded;
    - It is expected to be realized within 12 months after the balance sheet date; or
    - It is cash or a cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least 12 months after the balance sheet date.

    For example, current assets include cash and cash equivalents, accounts receivable, notes receivable, inventory and deferred income taxes, etc.
  - *Non-current assets* are those assets other than current assets. They include tangible assets (e.g. property, plant, and equipment) and non-tangible assets (e.g. goodwill). Property, plant, and equipment (PPE) is the largest non-current asset category for many industrial and manufacturing companies.

- **Liabilities.** Liabilities are present obligations of the company arising from past events, the settlement of which is expected to result in an outflow from the company of resources embodying economic benefits.

  - *Current liabilities* are those liabilities that satisfy any of the following criteria:

    – It is expected to be settled in the entity's normal operating cycle;

    – It is held primarily for the purpose of being traded;

    – It is due to be settled within 12 months after the balance sheet date; or

    – The entity does not have an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

    For example, short-term bank loan and other debt maturing within one year (i.e. amounts expected to be repaid during the next year), current portions of long-term debt and capitalized leases, accounts payable to suppliers, accrued liabilities, interest, and taxes payable are classified.

  - *Non-current liabilities* are those liabilities other than current liabilities. They include long-term bank loan, other long-term debt, capitalized lease obligations and pension obligations.

- **Equity.** Equity represents the residual interest in the assets of the company after all its liabilities have been deducted. It also equals to the share capital plus the retained earnings.

  - *Share capital* is the number of shares issued, multiplied by their nominal value.

  - *Retained earnings* are the total of all the accumulated profits and losses from all the accounting periods since the business set up.

**2.2. Income Statement.** Income Statement (or profit and loss account) is a statement of the income and expenditure of a business over the period stated. It indicates if a company has made a profit or loss during the period stated.

- **Income** includes both revenue and gains. It represents increases in economic benefits during the accounting period in form of inflows of assets and decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

- **Expenses** include losses as well as those expenses that arise in the course of the ordinary activities of the company. It represents the outflow in economic benefits.

Income Statement reports on making and selling activities of a business over a period of time. That is, profit or loss for the period equals to what is sold in the period minus what it cost to make, then minus selling and general expenses for the period. The followings are the key elements in Income Statement:

- **Operating revenue (or Turnover).** Sales are recorded when the company actually ships products to customers. Net sales means the total amount the company will ultimately collect from a sale, i.e., list price less any discounts offered to the customer to induce purchase.

- **Cost of sales (Cost of goods sold or COGS).** It is the account that the company uses to record the total direct cost of the product when a product is shipped and a sale is booked.

- **Gross profit (or Gross margin).** It is the amount left over from sales after cost of sales is taken out.

- **Operating expenses.** Operating expenses are those expenditures that a company makes to generate income including sales & marketing expense, research & development expenses, and general & administrative expenses.

- **Earning (Loss) before interests and taxes (EBIT or operating income).** This is the value of sales minus the cost of sales and operating expenses. If sales exceed cost of sales plus operating expenses, the business has earned income. If cost of sales plus operating expenses exceeds sales, a loss has occurred.

- **Net profit (or Net income).** This is the earning before interests and taxes (EBIT) plus non-operating income and minus non-operating expenses.

**2.3. Cash Flow Statement.** Information about the cash flows of an entity is useful in providing users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an entity to generate cash and cash equivalents and the timing and certainty of their generation.

The cash flow statement shall report cash flows during the period classified by operating, investing and financing activities:

- **Operating Activities.** Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. Therefore, they generally result from the transactions and other events that enter into the determination of profit or loss. Examples of cash flows from operating activities are:

    - Cash receipts from the sale of goods and the rendering of services;

    - Cash receipts from royalties, fees, commissions and other revenue;

    - Cash payments to suppliers for goods and services;

    - Cash payments to and on behalf of employees; and

    - Cash receipts and payments from contracts held for dealing or trading purposes.

A company shall report cash flows from operating activities using either:

- Direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

- Indirect method, whereby profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

Companies are encouraged to report cash flows from operating activities using the direct method. The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method.

- **Investing Activities.** The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Examples of cash flows arising from investing activities are:

  - Cash payments to acquire property, plant and equipment, intangibles and other long-term assets. These payments include those relating to capitalised development costs and self-constructed property, plant and equipment;

  - Cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;

  - Cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);

  - Cash advances and loans made to other parties (other than advances and loans made by a financial institution); and

  - Cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution).

- **Financing Activities.** The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of capital to the entity. Examples of cash flows arising from financing activities are:

  - Cash proceeds from issuing shares or other equity instruments;

  - Cash payments to owners to acquire or redeem the entity's shares;

  - Cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short or long-term borrowings;

  - Cash repayments of amounts borrowed; and

  - Cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

**2.4. Changes in Equity.** An entity should present changes in equity either in the notes to the financial statements or as a separate component of the financial statements. Changes in equity should include the following:

- The profit or loss for the period;
- Each item of income and expense, gain or loss, that as required by the SME-FRS is recognized directly in equity, and the total of these items;
- The cumulative effect of changes in accounting policy and the correction of prior period errors;
- Capital transactions with owners and distributions to owners;
- The balance of accumulated reserves at the beginning of the period and at the balance sheet date, and the movements for the period; and
- A reconciliation between the carrying amount of each class of equity capital, share premium and each reserve at the beginning and end of the period, separately disclosing each movement. Comparative information is not required for this reconciliation.

**2.5. Accounting policies and explanatory notes.** Information provided in the financial statements is augmented by accounting policies and explanatory notes. They are an integral part of the financial statements and provide data on such subjects as accounting methods, assumptions, and estimates used by management to develop the data reported in the financial statements. The notes to the financial statements should:

- Present information about the basis of preparation of the financial statements and the specific accounting policies selected and applied for significant transactions and events;
- Disclose the information required that is not presented elsewhere in the financial statements; and
- Provide additional information that is necessary for a proper presentation.

## 3. Benefits/Limitations

**3.1. Benefits.** The system of financial statements, augmented by footnotes and supplementary data, are interrelated and intended to provide understandable, relevant, reliable, comparable and timely information to make finance decisions, thus meet the objectives of financial plans, foster greater confidence of shareholders, and increase attractiveness of the company to potential investors.

**3.2. Limitations.** The balance between benefits (benefits derived from information provided in financial statements) and costs (cost of providing such information) is a pervasive constraint. Companies should evaluate the benefits and costs, so that the benefits derived from information should exceed the cost of providing it. Besides, financial statements are an approximation of economic reality because of the selective reporting of economic events by the accounting system, compounded by alternative accounting methods and estimates. Also, some items are carried at historical costs or market values, which could lead to inconsistency of the recording system.

## 4. Tools, Templates and Illustrations

### Template 4.1: Financial Statement Template

Please download the template at following website:
http://www.hkiod/eng/publication_highlights.asp

**XXXX Company**

**Balance Sheet**
*dd / mm / year*
*(In thousands of Hong Kong Dollars)*

| | *Current Year* | *Last Year* |
|---|---|---|
| ***Assets*** | | |
| *Current Assets* | | |
| Cash and cash equivalents | | |
| Short-term investments | | |
| Accounts receivable | | |
| Inventories | | |
| Equity investments | | |
| Prepaid expenses and other current assets | | |
| *Total Current Assets* | 0.00 | 0.00 |
| *Non-Current Assets* | | |
| Property, plant, and equipment at cost | | |
| Less accumulated depreciation | | |
| Property, plant, and equipment (net) | 0.00 | 0.00 |
| Long-term cash investments | | |
| Equity investments | | |
| Other non-current assets | | |
| *Total Non-Current Assets* | 0.00 | 0.00 |
| **Total Assets** | HK$- | HK$- |
| ***Liabilities*** | | |
| *Current Liabilities* | | |
| Loans payable and current portion long-term debt | | |
| Accounts payable and accrued expenses | | |
| Income taxes payable | | |
| Other current liabilities | | |
| *Total Current Liabilities* | 0.00 | 0.00 |
| *Long Term Debt* | | |
| Bonds payable | | |
| Long term notes payable | | |
| Other long term debt | | |
| *Total Long Term Debt* | 0.00 | 0.00 |
| **Total Liabilities** | 0.00 | 0.00 |

| | *Current Year* | *Last Year* |
|---|---|---|
| ***Equity*** | | |
| *Paid-in capital* | | |
| *Stock* | | |
| *Retained earnings* | | |
| **Total Equity** | 0.00 | 0.00 |
| **Total Liability and Equity** | HK$- | HK$- |

**Approved by:**

_____ _____
*Director* *Director*

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**XXXX Company**

**Profit and Loss Accounts**
*For the Fiscal Year Ended dd / mm / year*
*(In thousands of Hong Kong Dollars)*

| | *Current Year* | *Last Year* |
|---|---|---|
| **Sales Revenue** | | |
| **Cost of Sales** | | |
| **Gross Profit (Loss)** | 0.00 | 0.00 |
| ***Operating Expenses*** | | |
| Salaries and wages | | |
| Commissions | | |
| Advertising | | |
| Insurance | | |
| Rent | | |
| Utilities | | |
| Depreciation and amortization | | |
| Office supplies | | |
| Equipment maintenance and rental | | |
| Furniture and equipment | | |
| Other expenses | | |
| **Total Operating Expenses** | 0.00 | 0.00 |
| Investment and other income | | |
| Non-operating expenses | | |
| **Investment and other income (loss), net** | 0.00 | 0.00 |
| **Earning (Loss) Before Interest and Taxes** | 0.00 | 0.00 |
| Interest | | |
| Taxes on income (17.5%) | 0.00 | 0.00 |
| **Net Profit (Loss)** | HK$- | HK$- |

**Approved by:**

_____ _____
*Director* *Director*

**XXXX Company**

**Cash Flow Statement**
*For the Fiscal Year Ended dd / mm / year*
*(In thousands of Hong Kong Dollars)*

| | ***Current Year*** | ***Last Year*** |
|---|---|---|
| **Cash Flows from Operating Activities** | | |
| *Cash Inflows* | | |
| Cash received from customers | | |
| *Cash Outflows* | | |
| Cash paid for merchandise | | |
| Cash paid for wages and other operating expenses | | |
| Cash paid for interest | | |
| Cash paid for taxes | | |
| Other | | |
| **Net Cash Inflows (Outflows) from Operating Activities** | 0.00 | 0.00 |
| ***Cash Flows from Investing Activities*** | | |
| *Cash Inflows* | | |
| Cash received from sales of fixed assets | | |
| Cash received from disposition of business segments | | |
| Cash received from collection of notes receivable | | |
| Other | | |
| *Cash Outflows* | | |
| Cash paid for purchase of capital assets | | |
| Cash paid to acquire items not related to operations | | |
| Other | | |
| **Net Cash Inflows (Outflows) from Investing Activities** | 0.00 | 0.00 |
| ***Cash Flows from Financing Activities*** | | |
| *Cash Inflows* | | |
| Cash received from issuing stocks | | |
| Cash received from long-term borrowings | | |
| Other | | |
| *Cash Outflows* | | |
| Cash paid to repurchase stocks | | |
| Cash paid to retire long-term debt | | |
| Cash paid for dividends | | |
| Other | | |
| **Net Cash Inflows (Outflows) from Financing Activities** | 0.00 | 0.00 |
| *Increase (Decrease) of Cash During the Period* | 0.00 | |
| *Cash Balance at the Beginning of the Period* | 0.00 | |
| **Cash Balance at the End of the Period** | HK$- | HK$- |

**Approved by:**

_____ _____
*Director* *Director*

## 5. Further Readings/References


- "Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard." Hong Kong Institute of Certified Public Accountants, August 2005.

- Thomas R. Ittelson. "Financial Statements: A Step-By-Step Guide to Understanding and Creating Financial Report." 1998.

- Lyn M. Fraser and Aileen Ormiston. "Understanding Financial Statements, 8th Edition." 2006.

# The Hong Kong Institute of Directors

# Corporate Governance Toolkit

# Develop Management Reporting Package

Reference and page number in “Guidelines on corporate Governance for SMEs in Hong Kong”

| **Reference number** | **Page** | **Title → subtitle in Guidelines** |
|---|---|---|
| 2.5.37 | 36 | What governance practices do Hong Kong SMEs need? → Category 4 |
| 2.5.40 | 37 | What governance practices do Hong Kong SMEs need? → Category 4 |

Management practice cycle (“Guidelines on corporate Governance for SMEs in Hong Kong” page 8)

| **Cycle Number** | **Management practice cycle** |
|---|---|
| 1 | Planning |
| 6 | Controlling |

## 1. Overview

Without an effective reporting mechanism, management may be forced to compromise on its decision making process. Best practice organizations seek to match the information that is reported to the specific needs of the recipient at a specific time. Effective management reporting is about delivering the right information to the right people at the right time. A management reporting package should include both financial and non-financial information, predictive and historic data, for example: information on performance measures, key events, analysis, news and other information which support decision making.

## 2. What You Can Do

**2.1. Determine the documents and information to be included in the package.** There is no standard management reporting package for a company. Depending on the size of the company and the nature of its operations, management should set expectations on the information and frequency of reporting from its managers in order to ensure that the company's goals and objectives are met.

A basic package may include financial statements and ratio analysis, cash flow forecast, budget analysis, payroll analysis, stock aging analysis, reportable events (e.g. new brand of the company and/or of its competitors, changing regulations, key appointments/resignation of personnel/ management etc.)

**2.2. Understand each component of the package.**

- **Financial statements and ratios.** Financial statements are formal records of a business' financial activities. These statements provide an overview of a business' profitability and financial condition in both short and long term. There are four basic financial statements:
    - Balance sheet: also referred to as statement of financial condition, reports on a company's assets, liabilities and net equity as of a given point of time.
    - Income statement: also referred to as Profit or Loss statement, reports on a company's results of operations over a period of time.
    - Cash flow statement: reports on a company's cash flow activities, particularly its operating, investing and financing activities.
    - Statement of retained earnings: explains the changes in a company's retained earnings over the reporting period.

  Financial ratio is a ratio of selected values on an enterprise's financial statements. There are many standard ratios used to evaluate the overall financial condition of an organization. Financial ratios quantify many aspects of a business and are useful for management to make business decision. Financial ratios are categorized according to the financial aspect of the business which the ratio measures, such as liquidity ratios, activity ratios, debt ratios, profitability ratios and market ratios.

  Management is encouraged to attend formal training program/courses on finance management to enhance its understanding of the above reports.

- **Cash flow forecast.** It is an accounting item that refers to the amounts of cash being received and spent by a business during a defined period of time, sometimes tied to a specific project. Measurement of cash flow can be used to evaluate the state or performance of a business or project, determine problems with liquidity, generate project rate of returns and examine income or growth of a business when it is believed that accrual accounting concepts do not present economic realities. Alternatively, cash flow can be used as a tool to help 'validate' the net income generated by accrual accounting.

  Cash flows can be classified into 1) Operational cash flows, 2) Investment cash flows and 3) Financing cash flows. The cash flow statement can be examined to determine the short term sustainability of a company. If cash is increasing, then a company will often be deemed to be healthy in the short-term. Increasing or stable cash balances suggest that a company is able to meet its cash needs, and remain solvent. Cash flow statements may allow management to detect problems that would not be evident from the other financial statements alone.

- **Payroll analysis.** This allows management to obtain a broad understanding of the monetary compensation of the employees in the company. It is important that management also have a general understanding of the salaries in similar positions in different companies in order for them to benchmark the company with others and assess if the company's salaries are below, at similar level, or above industry standards. Subsequently, an item that could be included in the analysis is the industry data regarding payroll. The other items to be included in the analysis might vary depending on the level of detail needed by management. A simple analysis that might convey meaningful and important information could also include the mean salary, median salary, highest salary, lowest salary, range, and the standard deviation of the company as a whole and those of each department if applicable. Additionally, the company could try to determine if there is an appropriate balance between the salaries paid and productivity/seniority. Nevertheless, certain measures should be created in order to monitor that employees are neither overpaid nor underpaid.

- **Aging analysis.** Generally there are three common types of aging reports included in the management report packages:

  - **Accounts Receivable Aging.** This is a technique that indicates the proportion of the accounts receivable balance that has been outstanding for a specified period of time. The aging can be categorized as: Current, 0-30 days, 31-60 days, 61-90 days, over 90 days. By creating an aging, management can identify problem customers and manage the company's credit policy based upon industry standards. If the accounts receivable are abnormally long, there is a signal to management that more effort should be put on collection.

  - **Accounts Payable Aging.** This is a technique that indicates the proportion of the accounts payable balance that has been outstanding for a specified period of time. The aging can be categorized as: Current, 0-30 days, 31-60 days, 61-90 days, over 90 days. By creating an aging, management can identify embezzlement by Accounts Payable personnel, fraudulent invoices, etc.

  - **Stock Aging.** This is used to evaluate the purchase dates of the inventory on hand and inventory turnover rate. A stock aging analysis may provide information such as the date when the items were purchased, the value of such items, the date when the items were sold, and the remaining items/value on the inventory. By analyzing the stock aging, management can identify the obsolete stock and better plan for the future stock level.

- **Industry update.** It is important that management is provided a brief update of the industry situation in the reporting package. In this sense, management is able to determine if the internal situation of the company and the current and expected results are appropriate and sustainable with the conditions that exist on the market. Subsequently, a brief analysis may include a SWOT analysis (a strategic planning tool used to evaluate the strengths, weaknesses, opportunities, and threats in a project) and other informative items that would allow the directors to understand the external circumstances that could affect the company.

**2.3. Make decisions based on the information provided.** Based on the package provided, management should make the most appropriate decisions that benefit the stockholders. Those decisions could include the appointment and removal of senior management, and the modification of objectives among other issues. Based on the report, directors may also call for an extraordinary meeting and discuss the key issues that management must consider on the short-term/long term.

## 3. Benefits/Limitations

**3.1. Benefits.** A sound management reporting package is a key tool that the management can use in order to make the most appropriate decisions as they represent the stockholders. It provides an overall picture of the company, its internal/external environment, and its expected situation. Such decisions translate into better corporate governance and provide substantial benefits to the company.

**3.2. Limitations.** In the same manner that a sound management reporting package may provide substantial benefits, a poor one could hinder the success and reputation of the company. If the reporting package does not provide accurate information, or hide certain pieces of information, management will not be able to make sound decisions. In this sense, it is critical to understand that an accurate reporting package will highly depend on the existence of sound ethical principles among senior managers.

## 4. Tools, Templates and Illustrations

Please download the template at the following website:
http://www.hkiod.com/eng/publication_highlight.asp

**Template 4.1: Financial Statements and Financial Ratios Template**

**XXXX Company**

**Balance Sheet**
*dd / mm / year*
*(In thousands of Hong Kong Dollars)*

| | ***Current Year*** | ***Last Year*** |
|---|---|---|
| **Assets** | | |
| *Current Assets* | | |
| Cash and cash equivalents | | |
| Short-term investments | | |
| Accounts receivable | | |
| Inventories | | |
| Equity investments | | |
| Prepaid expenses and other current assets | | |
| *Total Current Assets* | 0.00 | 0.00 |

| | ***Current Year*** | ***Last Year*** |
|---|---|---|
| *Non-Current Assets* | | |
| Property, plant, and equipment at cost | | |
| Less accumulated depreciation | | |
| Property, plant, and equipment (net) | 0.00 | 0.00 |
| Long-term cash investments | | |
| Equity investments | | |
| Other non-current assets | | |
| *Total Non-Current Assets* | 0.00 | 0.00 |
| **Total Assets** | HK$- | HK$- |
| ***Liabilities*** | | |
| *Current Liabilities* | | |
| Loans payable and current portion long-term debt | | |
| Accounts payable and accrued expenses | | |
| Income taxes payable | | |
| Other current liabilities | | |
| *Total Current Liabilities* | 0.00 | 0.00 |
| *Long Term Debt* | | |
| Bonds payable | | |
| Long term notes payable | | |
| Other long term debt | | |
| *Total Long Term Debt* | 0.00 | 0.00 |
| **Total Liabilities** | 0.00 | 0.00 |
| ***Equity*** | | |
| *Paid-in capital* | | |
| *Stock* | | |
| *Retained earnings* | | |
| **Total Equity** | 0.00 | 0.00 |
| **Total Liability and Equity** | HK$- | HK$- |

**Approved by:** _____ _____

*Director* *Director*

**XXXX Company**

**Profit and Loss Accounts**
*For the Fiscal Year Ended dd / mm / year*
*(In thousands of Hong Kong Dollars)*

| | ***Current Year*** | ***Last Year*** |
|---|---|---|
| ***Sales Revenue*** | | |
| ***Cost of Sales*** | | |
| ***Gross Profit (Loss)*** | 0.00 | 0.00 |
| ***Operating Expenses*** | | |
| Salaries and wages | | |
| Commissions | | |
| Advertising | | |
| Insurance | | |
| Rent | | |
| Utilities | | |
| Depreciation and amortization | | |
| Office supplies | | |
| Equipment maintenance and rental | | |
| Furniture and equipment | | |
| Other expenses | | |
| **Total Operating Expenses** | 0.00 | 0.00 |
| Investment and other income | | |
| Non-operating expenses | | |
| **Investment and Other Income (Loss), Net** | 0.00 | 0.00 |
| ***Earning (Loss) Before Interest and Taxes*** | 0.00 | 0.00 |
| Interest | | |
| Taxes on income (17.5%) | 0.00 | 0.00 |
| **Net Profit (Loss)** | HK$- | HK$- |

**Approved by:**

_____ _____
*Director* *Director*

**XXXX Company**

**Cash Flow Statement**
*For the Fiscal Year Ended dd / mm / year*
*(In thousands of Hong Kong Dollars)*

| | ***Current Year*** | ***Last Year*** |
|---|---|---|
| ***Cash Flows from Operating Activities*** | | |
| *Cash Inflows* | | |
| Cash received from customers | | |
| *Cash Outflows* | | |
| Cash paid for merchandise | | |
| Cash paid for wages and other operating expenses | | |
| Cash paid for interest | | |
| Cash paid for taxes | | |
| Other | | |
| **Net Cash Inflows (Outflows) from Operating Activities** | 0.00 | 0.00 |
| ***Cash Flows from Investing Activities*** | | |
| *Cash Inflows* | | |
| Cash received from sales of fixed assets | | |
| Cash received from disposition of business segments | | |
| Cash received from collection of notes receivable | | |
| Other | | |
| *Cash Outflows* | | |
| Cash paid for purchase of capital assets | | |
| Cash paid to acquire items not related to operations | | |
| Other | | |
| **Net Cash Inflows (Outflows) from Investing Activities** | 0.00 | 0.00 |
| ***Cash Flows from Financing Activities*** | | |
| *Cash Inflows* | | |
| Cash received from issuing stocks | | |
| Cash received from long-term borrowings | | |
| Other | | |
| *Cash Outflows* | | |
| Cash paid to repurchase stocks | | |
| Cash paid to retire long-term debt | | |
| Cash paid for dividends | | |
| Other | | |
| **Net Cash Inflows (Outflows) from Financing Activities** | 0.00 | 0.00 |
| *Increase (Decrease) of Cash During the Period* | 0.00 | |
| *Cash Balance at the Beginning of the Period* | 0.00 | |
| **Cash Balance at the End of the Period** | HK$- | HK$- |

**Approved by:** _____ _____

*Director* *Director*

### Financial Performance Indicators

***Short Term Financial Indicators***

- Current Ratio –
- Quick Ratio –
- Inventory Turnover –
- Net Working Capital –
- Current Liabilities to Inventory Ratio –
- Cash Ratio –
- Operating Ratio –
- Advertising Expense to Sales ratio –

***Long Term Financial Indicators***

- Fixed Assets Turnover Ratio –
- Total Assets Ratio –
- Assets to Equity Ratio –

***Short Term (ST) and Long Term (LT) Capital Raising***

- Debt to Sales Ratio (ST) –
- Earnings to Sales Ratio (ST) –
- Interest Coverage Ratio (ST) –
- Total Debt Ratio –
- Debt Equity Ratio –
- Long Term Debt Equity Ratio (LT) –

***Performance***

- Return on Assets Ratio –
- Return on Equity Ratio –
- Profit Margin Ratio –

### Template 4.2: Cash Flow Forecast Template

**Cash Collections**
**(assuming that the company collects all accounts receivable in a three-month period)**

What percentage of sales is expected to be paid in the same period?..... _____
What percentage of sales is expected to be paid in the following period?..... _____

| | Total Sales | Period 1 | Period 2 | Period 3 | Period 4 | Period 5 |
|---|---|---|---|---|---|---|
| Period 1 | | HK$ - | HK$ - | HK$ - | | |
| Period 2 | | | HK$ - | HK$ - | - | |
| Period 3 | | | | HK$ - | - | - |
| Total Cash Collections | | HK$ - | HK$ - | HK$ - | - | - |

**Cash Disbursements**
**(assuming that the company pays all accounts payable in a three-month period)**

What percentage of purchases is expected to be paid in the same period?..... _____
What percentage of purchases is expected to be paid in the following period? _____

| | Total Purchases | Period 1 | Period 2 | Period 3 | Period 4 | Period 5 |
|---|---|---|---|---|---|---|
| Period 1 | | HK$ - | HK$ - | HK$ - | | |
| Period 2 | | | HK$ - | HK$ - | - | |
| Period 3 | | | | HK$ - | - | - |
| Total Cash Disbursements | | HK$ - | HK$ - | HK$ - | - | - |

**Cash Flow Forecast for Period 3**

Please indicate the minimum cash balance desired → _____

| | | |
|---|---|---|
| Expected Cash Collections | HK$ | - |
| Expected Cash Disbursements | HK$ | - |
| Excess (Deficiency) of available cash over cash disbursements | | 0.00 |
| Borrowings | HK$ | - |
| **Ending Cash Balance** | HK$ | - |

**Template 4.3: Payroll Analysis Template**

*You can upload up to 100 employees' data in this tool. After uploading the necessary data, use the "List" on the right side of each set title in order to obtain specific data of each set.*

| Employee (Last Name, First Name) | Position | Department | Monthly Salary |
|---|---|---|---|

**Statistical Analysis (All Payees)**

| | | |
|---|---|---|
| Count (Number of Salaries) | | 0.00 |
| Mean / Average | HK$ | - |
| Median | HK$ | - |
| Highest Salary | HK$ | - |
| Lowest Salary | HK$ | - |
| Range | HK$ | - |
| Standard Deviation | HK$ | - |

**Template 4.4: Stock Aging Analysis Template**

Input the year of purchase 2008

Input the frequency of purchase Daily

| Purchase Date | Units Purchases | Cost per Unit | Monthly Use | Remaining Inventory | Inventory Value | Accumulative Inventory Value |
|---|---|---|---|---|---|---|
| 1 January, 2008 | | | | - | HK$- | HK$- |
| 2 January, 2008 | | | | - | HK$- | HK$- |
| 3 January, 2008 | | | | - | HK$- | HK$- |
| 4 January, 2008 | | | | - | HK$- | HK$- |
| 5 January, 2008 | | | | - | HK$- | HK$- |
| 6 January, 2008 | | | | - | HK$- | HK$- |
| 7 January, 2008 | | | | - | HK$- | HK$- |
| 8 January, 2008 | | | | - | HK$- | HK$- |
| 9 January, 2008 | | | | - | HK$- | HK$- |
| 10 January, 2008 | | | | - | HK$- | HK$- |
| 11 January, 2008 | | | | - | HK$- | HK$- |
| 12 January, 2008 | | | | - | HK$- | HK$- |
| 13 January, 2008 | | | | - | HK$- | HK$- |
| 14 January, 2008 | | | | - | HK$- | HK$- |

## 5. Further Readings/References


- David A.J. Axson. “Best Practices in Planning and Management Reporting: From Data to Decisions.” 2003.
- Baruch Lev. “Intangibles: Management, Measurement, and Reporting.” 2001.
- Hans V.A. Johnsson and Per Erik Kihlstedt. “Performance-Based Reporting: New Management Tools for Unpredictable Times.” 2005

# The Hong Kong Institute of Directors

# Corporate Governance Toolkit

# Develop Budgets

Reference and page number in “Guidelines on corporate Governance for SMEs in Hong Kong”

| **Reference number** | **Page** | **Title → subtitle in Guidelines** |
|---|---|---|
| 2.2.2 (c) | 18 | What governance practices do Hong Kong SMEs need? → Category 1 |
| 2.5.39 | 36 | What governance practices do Hong Kong SMEs need? → Category 4 |
| 2.5.42 (e) | 38 | What governance practices do Hong Kong SMEs need? → Category 4 |
| 4.7.2 (e) | 53 | Management Practice Guidelines → Controlling |

Management practice cycle (“Guidelines on corporate Governance for SMEs in Hong Kong” page 8)

| **Cycle Number** | **Management practice cycle** |
|---|---|
| 1 | Planning |
| 2 | Key Performance Indicators (KPIs) |
| 3 | Operations/Implementation |
| 6 | Controlling |

## 1. Overview

A budget is a control tool expressed in quantitative terms that specifies how resources will be acquired and used during a specified period of time. A budget is critical for a business at every stage of the life cycle as it facilitates:

- **Planning:** by forcing the company to allocate priorities for the foreseeable future.
- **Communication and coordination:** by acting as a "communicator" as the budgeting process pulls together the plans of each department of a company.
- **Allocating resources:** by providing a means of allocating resources among competing uses.
- **Controlling profit and operations:** by serving as a benchmark to compare expected results with actual results. Such comparison enables management to evaluate the effectiveness of resources utilization.
- **Evaluating performance and providing incentives:** by comparing expected results with actual results, which enables management to evaluate the performance of individuals, departments or service lines. This can also provide incentives for people to perform better. Some companies even link the rewards system with the budgeting system by rewarding bonuses to managers who can meet or exceed the budgeted profit goals.

There is a misconception that budgeting is the sole responsibility of accounting and finance personnel. In fact, an effective, comprehensive budget requires the active input of management from each department, function, geography etc. Though the period covered by a budget is usually one fiscal year, i.e. a twelve-month period, it is important that the budget be revisited periodically (e.g. quarterly) to reassess whether assumptions used are still applicable for the rest of the period. Obviously, budgets for more significant capital expenditures (such as corporate level expansion and large scale acquisitions), may cover several years.

The main purpose of this toolkit is to introduce the concept of the level/extent of budgeting a company could take. Depending on the size of the company, it may require a budgeting software as additional support.

## 2. What You Can Do

Developing a master budget is a basic step of the budgeting process. A master budget is a comprehensive set of budgets covering major phases of a company. A master budget comprises of many separate, but interdependent budgets.

The three main levels of budgeting covered in this toolkit are 1) profit planning – forecast of revenues and expenses, 2) cash budgeting – forecast of cash needs and sources and 3) budgted financial statements. Samples of these budgets are explained below:

### 2.1. Profit planning budgeting

- **Sales revenue budget.** A sales revenue budget is developed based on the sales forecast of goods/services. A Sales forecast can be developed by considering past sales levels, general economic trends, industry trends, intended pricing policies and any planned advertising campaigns. A sales budget consists of the total projected sales of units in each period, multiplied by the sales price per unit, to determine the total projected sales revenue. (In the illustrated example, it is assumed that the per unit sales price of the finished good is $150 and for the projected sales in unit and calculation, please refer to Illustration 4.1)

- **Production budget.** A production budget shows the number of units of goods or services that are to be produced during the budget period. When determining the number of units produced, management should also consider the desired ending inventory of each period. In our example, management may wish to maintain an ending inventory of 10% of sales of the next quarter. In such case, the number of units produced for each period should be as follows:

  *Sales Units + Ending Inventory Desired = Total Units Required*

  *Total Units Required – Expected Beginning Inventory = Number of Units Produced*

  (For detailed calculations of the example, please refer to Illustration 4.2)

- **Direct Material Budget.** This budget shows the number of units and the cost of materials to be purchased and consumed during the budget period. First of all, management should consider how many units of each raw material required to produce 1 unit of finished good will be needed. Secondly management should identify the purchase cost of each type of raw material needed. Additionally, as mentioned above, management should also consider the desired ending inventory of raw material for each period. (In our example, we assume that 12 yards of fabric is required to produce 1 unit of finished good and each yard of fabric costs $9. For detailed calculations, please refer to Illustration 4.3)

- **Direct Labour Budget.** This budget shows the number of hours and the cost of labour to be used during the budget period. As above, management should consider how many labour hours are required to produce 1 unit of finished good and then, identify the cost of labour per hour. (In our example, we assume that 0.5 hour of labour is required to produce 1 unit of finished good and the cost of labour per hour is $15. For detailed calculations, please refer to Illustration 4.4)

- **Overhead Budget.** This budget represents overhead costs, such as indirect materials, indirect labour, utilities, rent, etc., expected to be incurred in the production process during the budget period. (For an example, please refer to Illustration 4.5)

- **Selling, General and Administrative (SG&A) Expense Budget.** This budget shows the planned amounts of expenditure for selling, general and administrative expenses during the budget period. This may include variable SG&A expenses, which vary with the number of sales units and fixed SG&A expenses, which are fixed regardless of the amount of sales units. (In the example, it is assumed that the variable SG&A rate is $0.05 per sales units. For detailed calculations, please refer to Illustration 4.6)

### 2.2. Cash budgeting

- **Receipt Budget.** This type of budget shows the expected cash collections during the budget period. Management should estimate the percentage of billings that the company can collect during each budget period. (In the example, it is assumed that 80% of the billing issued can be collected in the same quarter, and 18% of the billing can be collected in the next quarter, whereas the remaining 2% is expected to be uncollectible accounts. For detailed calculations, please refer to Illustration 4.7)

- **Cash Disbursement Budget.** This budget details the expected cash payments during the budget period. This includes the cash payments for raw materials purchased, direct labour, overhead expenses and SG&A expenses. Management needs to estimate the percentage of cash payment for materials purchased during each budget period. (In the example, it is assumed that 60% of the total cost of materials purchased is paid during the same quarter. The remaining 40% is paid in the next quarter. For detailed calculations, please refer to Illustration 4.8)

- **Cash Budget.** A cash budget summarizes the cash receipts and cash disbursements expected during the budget period and it also considers financing and repayment for each period. Ultimately, the budgeted cash balance as at period end will be calculated. (For detailed calculation, please refer to Illustration 4.9)

**2.3. Budgeted Financial Statement.** After preparing all the above budgets, management can prepare the budgeted financial statements, which include Budgeted Cash Flow Statement, Budgeted Income Statement and Budgeted Balance Sheet. Before we calculate the budgeted financial statements, management should first calculate the production cost of finished goods per unit and the budgeted finished goods ending inventory. (For detailed calculations, please refer to Illustration 4.10)

- **Budgeted Cash Flow Statement.** Budgeted Cash Flow Statements provide information about the expected sources and uses of cash for operating activities, investing activities and financing activities during a particular period of time. (For an example, please refer to Illustration 4.11)

- **Budgeted Income Statement.** Budgeted Income Statements provide the expected revenue and expenses for the budget period, assuming that the planned operations are carried out. (For an example, please refer to Illustration 4.12)

- **Budgeted Balance Sheet.** Budgeted Balance Sheets show the expected end-of-period balances for the company's assets, liabilities and equity, assuming the planned operations are carried out. (For an example, please refer to Illustration 4.13)

**2.4. Variance Analysis.** Variance analysis is to compare the budgeted amount with the actual results. It can be performed for various items, such as revenue, cost, material purchased cost, volume of material used, labour cost, labour hours used, overhead expenses, and selling expenses, etc. By understanding the variances, management will be able to assess past performance and plan for future actions.

In conclusion, a budget should be realistic and reflect the actual ability of the company and the conditions of the external market. Management should consider reviewing the budget on a regular basis and updating the budget based on relevant circumstances and the best information available.

## 3. Benefits/Limitations

**3.1. Benefits.** A budget is key tool in achieving a company's plans and objectives. It provides an opportunity for all levels of management to work together, so as to reinforce management's planning. A budget promotes teamwork, process improvement and goal congruency between the company and the employees and ultimately enables a more strategic and effective allocation of resources. In addition, it provides a basis for evaluating the managers' performance and the performance of their team. It also encourages managers to take financial responsibility.

**3.2. Limitations.** The effectiveness of the budgeting process largely depends on the quality of the budget prepared. Employees can be demotivated if they feel that the budgeted figures are too high to be realistically achieved. If an unrealistic budget is created and the company over-emphasizes the results, it can lead to management making decisions that may be detrimental to the company. For example, an over-ambitious sales budget could lead to the decision to provide steep discounts to increase overall sales volumes, which could have a disastrous impact on the company.

## 4. Tools, Templates and Illustrations

### Illustration 4.1: Sales Budget

| | | Q1 | Q2 | Q3 | Q4 | Year |
|---|---|---|---|---|---|---|
| Budgeted Sales (Units) | | 5,000 | 15,000 | 20,000 | 10,000 | 50,000 |
| Unit Sales Price | X | $150 | $150 | $150 | $150 | $150 |
| Sales Revenue | | $750,000 | $2,250,000 | $3,000,000 | $1,500,000 | $7,500,000 |

### Illustration 4.2: Production Budget

| | | Q1 | Q2 | Q3 | Q4 | Year |
|---|---|---|---|---|---|---|
| Sales in Units | | 5,000 | 15,000 | 20,000 | 10,000 | 50,000 |
| Add Desiring Ending Inventory* # | + | 1,500 | 2,000 | 1,000 | 500 | 500 |
| Total Units Requried | | 6,500 | 17,000 | 21,000 | 10,500 | 50,500 |
| Less Expecting Begining Inventory | – | 500 | 1,500 | 2,000 | 1,000 | 500 |
| Units to be Produced | | 6,000 | 15,500 | 19,000 | 9,500 | 50,000 |

* Desired Ending Inventory is 10% of next quarter's sales

# For Q4, it is an estimated figure for 10% of the Desired Ending Inventory of next year Q1

### Illustration 4.3: Direct Material Budget

| | | Q1 | Q2 | Q3 | Q4 | Year |
|---|---|---|---|---|---|---|
| Finished Goods to be Produced | | 6,000 | 15,500 | 19,000 | 9,500 | 50,000 |
| Raw Material Required/Unit (Yards) | X | 12 | 12 | 12 | 12 | 12 |
| Raw Material Required for Production (Yards) | | 72,000 | 186,000 | 228,000 | 114,000 | 600,000 |
| Add Desiring Ending Inventory* # | + | 18,600 | 22,800 | 11,400 | 7,200 | 7,200 |
| Total Raw Material Required | | 90,600 | 208,800 | 239,400 | 121,200 | 607,200 |
| Less Expected Beginning Inventory | – | 7,200 | 18,600 | 22,800 | 11,400 | 7,200 |
| Raw Material to be Purchased | | 83,400 | 190,200 | 216,600 | 109,800 | 600,000 |
| Cost per Yard | X | $9 | $9 | $9 | $9 | $9 |
| Total Cost of Raw Material | | $750,600 | $1,711,800 | $1,949,400 | $988,200 | $5,400,000 |

* 10% of next period raw material requirement

# For Q4, it is an estimated figure for 10% of the Desired Ending Inventory of next year Q1

### Illustration 4.4: Direct Labour Budget

| | | Q1 | Q2 | Q3 | Q4 | Year |
|---|---|---|---|---|---|---|
| Finished Goods to be Produced | | 6,000 | 15,500 | 19,000 | 9,500 | 50,000 |
| Direct Labour Required (hour) | X | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| Total Labour Hour Required | | 3,000 | 7,750 | 9,500 | 4,750 | 25,000 |
| Cost of Labour/Hour | X | $15 | $15 | $15 | $15 | $15 |
| Total Cost of Labour | | $45,000 | $116,250 | $142,500 | $71,250 | $375,000 |

**Illustration 4.5: Overhead Budget**

| | | Q1 | Q2 | Q3 | Q4 | Year |
|---|---|---|---|---|---|---|
| Indirect Labour | | $17,500 | $26,500 | $17,900 | $24,000 | $85,900 |
| Indirect Material | | $7,000 | $12,600 | $8,600 | $9,600 | $37,800 |
| Utilities | | $4,200 | $8,400 | $5,200 | $6,400 | $24,200 |
| Rent | | $13,300 | $13,300 | $13,300 | $13,300 | $53,200 |
| Insurance | | $5,800 | $5,800 | $5,800 | $5,800 | $23,200 |
| Maintenance | + | $8,200 | $16,000 | $8,200 | $16,000 | $48,400 |
| Total Overhead | | $56,000 | $82,600 | $59,000 | $75,100 | $272,700 |

**Illustration 4.6: Selling, General and Administrative Budget**

| | | Q1 | Q2 | Q3 | Q4 | Year |
|---|---|---|---|---|---|---|
| Sales in Units | | 5,000 | 15,000 | 20,000 | 10,000 | 50,000 |
| Variable SG&A Rate | X | $0.5 | $0.5 | $0.5 | $0.5 | $0.5 |
| Variable Expense | | $2,500 | $7,500 | $10,000 | $5,000 | $25,000 |
| **Fixed Expense** | | | | | | |
| Sales Team Salary | | $15,000 | $15,000 | $15,000 | $15,000 | $60,000 |
| Advertising | | $6,000 | $6,000 | $6,000 | $6,000 | $24,000 |
| Administrative Salary | + | $20,000 | $20,000 | $20,000 | $20,000 | $80,000 |
| Total SG&A Expense | | $43,500 | $48,500 | $51,000 | $46,000 | $189,000 |

**Illustration 4.7: Cash Receipts Budget**

| | | Q1 | Q2 | Q3 | Q4 | Year |
|---|---|---|---|---|---|---|
| **Beginning Accounts Receivable*** | | $5,000 | | | | $5,000 |
| **Q1 Sales** | | | | | | |
| 80% of Billings | | $600,000 | | | | $600,000 |
| 18% of Billings | | | $135,000 | | | $135,000 |
| **Q2 Sales** | | | | | | |
| 80% of Billings | | | $1,800,000 | | | $1,800,000 |
| 18% of Billings | | | | $405,000 | | $405,000 |
| **Q3 Sales** | | | | | | |
| 80% of Billings | | | | $2,400,000 | | $2,400,000 |
| 18% of Billings | | | | | $540,000 | $540,000 |
| **Q4 Sales** | | | | | | |
| 80% of Billings | + | | | | $1,200,000 | $1,200,000 |
| **Total Cash Receipts** | | $605,000 | $1,935,000 | $2,805,000 | $1,740,000 | $7,085,000 |

* Beginning accounts receivable is brought forward from last fiscal year. It is assumed to be fully collected in Q1.

### Illustration 4.8: Cash Disbursement Budget

| | | Q1 | Q2 | Q3 | Q4 | Year |
|---|---|---|---|---|---|---|
| **Beginning Accounts Payable*** | | $6,000 | | | | $6,000 |
| **Q1 Material Purchase** | | | | | | |
| 60% of Purchase | | $450,360 | | | | $450,360 |
| 40% of Purchase | | | $300,240 | | | $300,240 |
| **Q2 Material Purchase** | | | | | | |
| 60% of Purchase | | | $1,027,080 | | | $1,027,080 |
| 40% of Purchase | | | | $684,720 | | $684,720 |
| **Q3 Material Purchase** | | | | | | |
| 60% of Purchase | | | | $1,169,640 | | $1,169,640 |
| 40% of Purchase | | | | | $779,760 | $779,760 |
| **Q4 Material Purchase** | | | | | | |
| 60% of Purchase | + | | | | $592,920 | $592,920 |
| **Total Material Purchase Payment** | | $456,360 | $1,327,320 | $1,854,360 | $1,372,680 | $5,010,720 |
| **Other Cash Disbursement** | | | | | | |
| **Direct Labour** | | $45,000 | $116,250 | $142,500 | $71,250 | $375,000 |
| **Indirect Labour** | | $17,500 | $26,500 | $17,900 | $24,000 | $85,900 |
| **Indirect Material** | | $7,000 | $12,600 | $8,600 | $9,600 | $37,800 |
| **Utilities** | | $4,200 | $8,400 | $5,200 | $6,400 | $24,200 |
| **Rent** | | $13,300 | $13,300 | $13,300 | $13,300 | $53,200 |
| **Insurance** | | $5,800 | $5,800 | $5,800 | $5,800 | $23,200 |
| **Maintenance** | | $8,200 | $16,000 | $8,200 | $16,000 | $48,400 |
| **SG&A Variable Expense** | | $2,500 | $7,500 | $10,000 | $5,000 | $25,000 |
| **Sales Team Salary** | | $15,000 | $15,000 | $15,000 | $15,000 | $60,000 |
| **Advertising** | | $6,000 | $6,000 | $6,000 | $6,000 | $24,000 |
| **Administrative Salary** | + | $20,000 | $20,000 | $20,000 | $20,000 | $80,000 |
| **Total Other Disbursement** | | $144,500 | $247,350 | $252,500 | $192,350 | $836,700 |
| **Total Cash Disbursement** | | $600,860 | $1,574,670 | $2,106,860 | $1,565,030 | $5,847,420 |

* Beginning accounts payable is brought forward from last fiscal year. It is assumed to be fully paid in Q1.

### Illustration 4.9: Cash Budget

| | | Q1 | Q2 | Q3 | Q4 | Year |
|---|---|---|---|---|---|---|
| Cash Receipt | | $605,000 | $1,935,000 | $2,805,000 | $1,740,000 | $7,085,000 |
| Cash Disbursement | – | $600,860 | $1,574,670 | $2,106,860 | $1,565,030 | $5,847,420 |
| Change in Cash Balance due to Operations | | $4,140 | $360,330 | $698,140 | $174,970 | $1,237,580 |
| Payments for Construction of Plant Addition | | ($10,000) | | ($10,000) | | ($20,000) |
| Proceeds from Bank Loan (Beginning of Q1) | | $10,000 | | | | $10,000 |
| Repayments (at the end of each Quarter) | | ($2,500) | ($2,500) | ($2,500) | ($2,500) | ($10,000) |
| Interest on Bank Loan (10%/Year) | + | ($250) | ($188) | ($125) | ($63) | ($625) |
| Total Cash Balance | | $1,390 | $357,643 | $685,515 | $172,408 | $1,216,955 |
| Cash Balance as at Beginning of Q1 | | | | | | $560,000 |
| Cash Balance as at End of Q4 | | | | | | $1,776,955 |

* Beginning accounts receivable is brought forward from last fiscal year. It is assumed to be fully collected in Q1.

### Illustration 4.10: Budgeted Production Cost per Unit and Ending Finished Goods Inventory

Assumption: Manufacturing Overhead is applied on the basis of direct labour hours

| **Production Cost / Unit** | **Quantity** | **Cost** | **Total** |
|---|---|---|---|
| Direct Material | 12 Yards | $9 | $108 |
| Direct Labour | 0.5 Hour | $15 | $8 |
| Manufacturing Overhead * | 0.5 Hour | $11 | $5 |
| | | | 121 |
| **Budgeted Ending Inventory** | | | |
| Ending Inventory in Units | | | 500 |
| Unit Production Cost | | | $121 |
| **Ending Finished Goods Inventory** | | | $60,477 |

$$\text{* Manufacturing Overhead Rate} = \frac{\text{Total Overhead}}{\text{Total Labour Hours}}$$

$$= \frac{\$272,700}{25000}$$

$$= \$11$$

**Illustration 4.11: Budgeted Cash Flow Statement**

| | | |
|---|---|---|
| **Cash Flow from Operating Activities** | | |
| **Cash Receipts from Customers** | | $7,085,000 |
| Cash Payments: | | |
| To Suppliers of Raw Materials | $5,010,720 | |
| For Direct Labour | $375,000 | |
| For Manufacturing Overhead Expenditures | $272,700 | |
| For Selling, General and Administrative Expenses | $189,000 | |
| For Interest | $625 | |
| **Total Cash Payments** | | $5,848,045 |
| **Net Cash Flow from Operating Activities** | | $1,236,955 |
| **Cash Flow from Investing Activities** | | |
| Construction of Plant Addition | ($20,000) | |
| **Net Cash Flow from Investing Activities** | | ($20,000) |
| **Cash Flow from Financing Activities** | | |
| Principal from Bank Loan | $10,000 | |
| Repayment of Bank Loan | ($10,000) | |
| **Net Cash Flow from Financing Activities** | | $0 |
| **Net Increase in Cash and Cash Equivalents** | | $1,216,955 |
| **Balance in Cash and Cash Equivalents, Beginning of Year** | | $560,000 |
| **Balance in Cash and Cash Equivalents, End of Year** | | $1,776,955 |

**Illustration 4.12: Budgeted Income Statement**

| | | |
|---|---|---|
| **Sales Revenue** | | $7,500,000 |
| **Less: Cost of Goods Sold *** | | $6,047,700 |
| **Gross Margin** | | $1,452,300 |
| **Operating Expense:** | | |
| Selling, General & Administrative Expense | $189,000 | |
| Interest Expense | $625 | |
| **Total Operating Expense** | | $189,625 |
| **Net Income** | | $1,262,675 |

* Cost of goods sold = Number of Units Produced X Production Unit Cost

**Illustration 4.13: Budgeted Balance Sheet**

| | |
|---|---|
| **Current Assests:** | |
| **Cash** | $1,776,955 |
| **Accounts Receivable (Note 1)** | $270,000 |
| **Inventory** | |
| Raw Material (Note 2) | $86,400 |
| Finished Goods (Note 3) | $60,477 |
| **Total Current Assets** | $2,193,832 |
| **Property and Equipment (Note 4)** | |
| Land | $5,000,000 |
| Building | $1,480,000 |
| Equipment | $96,000 |
| **Total Property and Equipment** | $6,576,000 |
| **Total Assets** | $8,769,832 |
| **Accounts Payable (Note 5)** | $395,280 |
| **Common Stock (Note 6)** | $5,811,877 |
| **Retained Earnings (Note 7)** | $2,562,675 |
| **Total Liabilities and Equity** | $8,769,832 |

(Note 1) Accounts Receivable = 18% of Q4 Sales Billings
(Note 2) Raw Material = Ending Inventory of Q4 X Cost
(Note 3) Finished Goods = Ending Inventory X Production Unit Cost
(Note 4) It is based on the assumption that Land = $5,000,000; Building (net) = $1,480,000; Equipment = $96,000
(Note 5) Accounts Payable = 40% of Q4 purchase
(Note 6) It is based on the assumption that common stock = $5,811,877
(Note 7) It is based on the assumption that beginning retained earning is $ 1,300,000.
Ending retained earning = Beginning Balance + Net Income

Please download the template at the following website:
http://www.hkiod.com/eng/publication highlight.asp

## 5. Further Reading


- Robert Rachlin, “Handbook of Budgeting, Fourth Edition”, John Wiley & Sons. 1999.
- William Rea Lalli, “Handbook of Budgeting: 2006 Cumulative Supplement, Fifth Edition”, John Wiley & Sons, 2006.

# The Hong Kong Institute of Directors

# Corporate Governance Toolkit

# Develop Performance Indicators

Reference and page number in “Guidelines on corporate Governance for SMEs in Hong Kong”

| **Reference number** | **Page** | **Title → subtitle in Guidelines** |
|---|---|---|
| 2.2.2 (c) | 18 | What governance practices do Hong Kong SMEs need? → Category 1 |
| 2.3.2 (c) | 19 | What governance practices do Hong Kong SMEs need? → Category 2 |
| 2.4.3 (e) | 24 | What governance practices do Hong Kong SMEs need? → Category 3 |
| 2.4.4 (e) | 25 | What governance practices do Hong Kong SMEs need? → Category 3 |
| 4.2.3 | 48 | Management Practice Guidelines → Planning |
| 4.3.1 | 49 | Management Practice Guidelines → Examples of key performance indicators |
| 4.3.2 | 50 | Management Practice Guidelines → Examples of key performance indicators |
| 4.3.3 | 50 | Management Practice Guidelines → Examples of key performance indicators |
| 4.5.3 (a) | 52 | Management Practice Guidelines → Organizing |
| 4.5.3 (e) | 52 | Management Practice Guidelines → Organizing |

Management practice cycle (“Guidelines on corporate Governance for SMEs in Hong Kong” page 8)

| **Cycle Number** | **Management practice cycle** |
|---|---|
| 1 | Planning |
| 2 | KPIs |
| 4 | Organising |
| 6 | Controlling |

## 1. Overview

Key performance indicators ("KPI") represent a set of measures focusing on those aspects of organizational performance that are the most critical for the current and future success of the organization. KPIs are an influential communication tool and are powerful driver of change in organizations. They should be applied throughout the organization and they influence the organization by driving managerial behaviour, focusing managers' attention, providing feedback on performance, promotions and compensation decisions, identifying problem areas, guiding and directing improvement efforts, as well as creating and reinforcing corporate culture.

KPIs can be viewed from two dimensions:

- **Lagging indicator vs. leading indicator:** Lagging indicators act as a measure of whether a company has successfully achieved its goals. They are reflective, and are beneficial for measuring performance against prior goals. Leading indicators on the other hand act as predictors of a company's ability to meet its future goals. These indicators are beneficial for forecasting as well as for setting and modifying goals.

- **Financial indicator vs. non-financial indicators:** Examples of financial indicators are sales revenue, costs, and profitability; and examples for non-financial indicators are competitiveness, productivity and innovation, quality of products/services, resource utilization and flexibility, customer satisfaction and employee benefits. The primary difference between these two types of indicators are that financial performance measures apply to all businesses and industries whereas non-financial performance measures may vary widely according to different industries, company and reporting levels.

## 2. What You Can Do

**2.1. Identify the overall business strategy.** Before developing KPIs, management needs to determine the overall business strategy of the company and identify what the business is trying to accomplish concerning sales, finance, human resources, supply chain, etc. Management should identify both short and long-term objectives related to the corporate strategy.

**2.2. Identify KPI stakeholders.** In this step, management should determine resources from within the company that will ultimately validate and approve the KPIs and supporting metrics. This enhances the accountability of the whole KPI establishment and monitoring processes.

**2.3. Identify key business drivers.** Management should identify the important execution steps necessary to meet the goals and objectives of the company. A list of primary business drivers in line with the corporate strategy should be produced. For example, if the strategic goal is to be the number one supplier in the industry, then some key business drivers might be the number (and effectiveness) of the distribution channels, the quality of the sales force, and the organization's ability to retain and reference existing customers.

**2.4. Create KPI categories.** Management should organize the key business drivers into KPI categories. The categories typically correspond to a major area of functionality (for example, Supply Chain, Financials, Sales and Marketing, Human Resources, and so on).

**2.5. Identify and develop KPIs.** Management should identify and develop the measures of success that are tied to the drivers and categories identified in the previous steps. A list of logistical KPIs that measures how the company is performing against the business drivers should be produced. For example, management might select KPIs such as channel growth (revenue as well as quantity), client satisfaction level, client retention rate, and sales win rate (as a reflection of sales staff quality). When developing the KPIs, the following questions should be considered:

- Is it *key*? Key in this context means most important or most relevant.
- Is it related to *performance*? The metric must be related to performance and, in particular, managing performance.
- Is it an *indicator*? The metric must indicate some result or pending result.

When identifying and developing KPIs, we should consider two perspectives:

- **Lagging indicators vs. Leading indicators.** Companies, which have revenues of under US$ 50million and have fewer than 300 employees, are early in their development. Depending on a company's industry, it will likely have a limited set of products, a limited set of customers, and service customers in a limited set of geographies. Longer-term objectives and growth plans are secondary in importance to shorter-term issues. Key issues for these companies include proving the viability of the product or concept, becoming operational, and generating revenues. Research uncovered that issues related to customers and issues concerning financial health are of critical importance for these companies. Given this dual-focus, companies stressed the balance they required between growth and productivity objectives. They lamented past periods of imbalance and reaffirmed that growth for the sake of growth was no longer a consideration. Examples of lagging indicators for these companies are revenue growth, market share and cash position. Whereas for leading indicators, these companies should focus on receivables turnover, inventory turnover, customer acquisition cost, cancelled orders, etc.

  Companies, which have revenues of between US$50 million and US$200 million and have between 300-1,000 employees, have completed the start-up and initial growth phases. Early risks related to product development, customer acceptance, and financial health are largely behind them. Structure and processes around activities centered on product development and sales and marketing are increasingly necessary. Companies at this stage are primarily focused on establishing a market for their products and becoming financially sustainable. The research uncovered that issues related to customers, employees and organizational development are of critical importance during this stage. With increased complexity, companies typically feel the need to formalize processes that had largely occurred organically. Related to this, companies reaffirmed that the active involvement of executives in the day-to-day operations was still seen as vital to the business. Examples of lagging indicators for these companies are profitability, cost measures, revenue growth and market share. Whereas for leading indicators, these companies should focus on new product development, employee turnover, customer selectivity, etc.

- **Financial indicators vs. Non-financial indicators.** A good approach is to have a mix of financial and non-financial measure with a 50/50 optimal split. Below are some examples of these two types of indicators:

  - **Financial Performance Indicator.** Financial measures generally look at the past: that is, at how the organization has performed historically. Below are some sample financial performance indicators:

| **Short-Term Focus** | |
|---|---|
| Current Ratio | Current Assets/Current Liabilities |
| Quick Ratio: | Quick Assets (Current Assets less Inventories)/Current Liabilities |
| Inventory Turnover Period | Inventories/Cost of Sales |
| Net Working Capital | (Current Assets – Current Liabilities)/Total Assets |
| Current Liabilities to Inventory Ratio | Current Liabilities/Inventory |
| Cash Ratio | Cash and Cash Equivalence/Current Liabilities |
| Operating Ratio | Operating Expense/Operating Income |
| Advertising Expense to Sales Ratio | Advertising Expense/Total Sales |
| Marketing Expense to Sales Ratio | Marketing Expense/Total Sales |

| **Long-Term Focus** | |
|---|---|
| Fixed Assets Turnover Ratio | Total Sales/Fixed Assets |
| Total Assets Ratio | Total Sales/Total Assets |
| Assets to Equity Ratio | Total Assets/Equity |

| **Capital Raising Focus** | |
|---|---|
| Debt to Purchases Ratio | Credit Sales/Purchases |
| Total Debt Ratio | Total Liabilities/Total Asset |
| Debt to Equity Ratio | Total Liabilities/Total Equity |
| Interest Coverage Ratio | EBIT/Interest Expense |

| **Solvency Focus** | |
|---|---|
| Long Term Debt to Equity Ratio | Long-term Liabilities/Total Equity |
| Interest Coverage Ratio | EBIT/Interest Expense |

- **Non-Financial Performance Indicators.** Non-financial measures frequently offer a good indicator of the future – in other words, how the financial measure might look in time. For example, if client satisfaction is trending down today, it is very likely that future revenue streams will move in the same direction as clients either fail to renew maintenance agreements or refuse to be references for new prospects. Below are some sample non-financial performance indicators:

  – **Human Resources**

    - Employee turnover
    - Satisfaction with the company, department or position
    - Training budget/hour per employee
    - Attendance of staff function
    - Payroll check errors

  – **Operational**

    - Process cycle time
    - Product defective rate
    - Lost production due to maintenance
    - IT, telecom, office supply & networking costs as a percentage of revenue
    - Payment processing time

  – **Sales and Customer Service**

    - Percentage of sales from new products
    - Percentage of sales from proprietary products
    - New product introductions vs. competitors
    - Time required to develop next generation of products
    - Time required to market new products
    - Warranty and repair costs
    - After-sales response time
    - Customer satisfaction percentage

- Number of customers lost
- Number of customers returned
- Number of orders received in period
- Percentage market share achieved
- Percentage defect rates of purchased materials/components
- Percentage defect rates of products
- Number of warranty claims
- Adherence to delivery dates
- Number of customers acquired annually
- Top 25 new customers
- Percentage of repeat orders
- Out-of-stock percentage

**2.6. Deliver supporting metrics.** After identifying the KPIs, management should develop the detailed measures that feed and augment the KPIs. A matrix document that identifies key supplemental measures related to each KPI (for example, frequency, latency, granularity, mode of collection, and visualization requirements) should be established. For detail, please refer to Template 4.2 below.

**2.7. Conduct KPI review sessions.** KPI review sessions are typically held with KPI stakeholders and corresponding representatives. The goal of the review sessions is to build consensus within the organization for KPI definition and supporting metrics. The KPI review sessions may occur in an iterative fashion, depending on number and frequency of KPI updates required.

**2.8. Complete the KPI sign-off process.** Formal sign-off from KPI stakeholders should be obtained. The sign-off process can be conducted at the conclusion of the KPI review sessions or through independent communication channels, such as e-mail or via a formal documentation repository (for example, storage of the KPI document within the repository serves as formal document approval from stakeholders).

## 3. Benefits/Limitations

**3.1. Benefits.** Determining appropriate performance indicators can promote sustainability, competitiveness, accountability and completeness. Performance indicators should not be developed solely on company-specific measures. Performance indicators can be broadened by integrating industry-wide measures in order for companies to compare themselves with competitors and best practices in the same industry.

**3.2. Limitations.** The limitation of performance indicators is that they cannot be viewed as a routine to be standardized without taking into consideration the differences among industries and among firms within the same industry; otherwise, this could lead to grossly incorrect conclusions. Additionally, there are challenges faced with regards to non-financial performance indicators as a result of trying to quantify and assess non-tangible elements of an organization and link them to financial situations.

## 4. Tools, Templates and Illustrations

**Template 4.1: Financial KPI Template**
Please download the Template at the following website:
http://www.hkiod.com/eng/publication_highlight.asp

**XXXX Company**

**Balance Sheet**
*dd / mm / year*
*(In thousands of Hong Kong Dollars)*

| | Current Year | Last Year |
|---|---|---|
| **Assets** | | |
| *Current Assets* | | |
| Cash and cash equivalents | | |
| Short-term investments | | |
| Accounts receivable | | |
| Inventories | | |
| Equity investments | | |
| Prepaid expenses and other current assets | | |
| *Total Current Assets* | 0.00 | 0.00 |
| *Non-Current Assets* | | |
| Property, plant, and equipment at cost | | |
| Less accumulated depreciation | | |
| Property, plant, and equipment (net) | 0.00 | 0.00 |
| Long-term cash investments | | |
| Equity investments | | |
| Other non-current assets | | |
| *Total Non-Current Assets* | 0.00 | 0.00 |
| **Total Assets** | HK$- | HK$- |

| | Current Year | Last Year |
|---|---|---|
| **Liabilities** | | |
| *Current Liabilities* | | |
| Loans payable and current portion long-term debt | | |
| Accounts payable and accrued expenses | | |
| Income taxes payable | | |
| Other current liabilities | | |
| *Total Current Liabilities* | 0.00 | 0.00 |
| *Long Term Debt* | | |
| Bonds payable | | |
| Long term notes payable | | |
| Other long term debt | | |
| *Total Long Term Debt* | 0.00 | 0.00 |
| **Total Liabilities** | 0.00 | 0.00 |
| **Equity** | | |
| *Paid-in capital* | | |
| *Stock* | | |
| *Retained earnings* | | |
| **Total Equity** | 0.00 | 0.00 |
| **Total Liability and Equity** | HK$- | HK$- |

**Approved by:** _____ _____

*Director* *Director*

**XXXX Company**

**Profit and Loss Accounts**
*For the Fiscal Year Ended dd / mm / year*
*(In thousands of Hong Kong Dollars)*

| | Current Year | Last Year |
|---|---|---|
| **Sales Revenue** | | |
| **Cost of Sales** | | |
| **Gross Profit (Loss)** | 0.00 | 0.00 |
| **Operating Expenses** | | |
| Salaries and wages | | |
| Commissions | | |
| Advertising | | |
| Insurance | | |
| Rent | | |
| Utilities | | |
| Depreciation and amortization | | |
| Office supplies | | |
| Equipment maintenance and rental | | |
| Furniture and equipment | | |
| Other expenses | | |
| **Total Operating Expenses** | 0.00 | 0.00 |
| Investment and other income | | |
| Non-operating expenses | | |
| **Investment and other income (loss), net** | 0.00 | 0.00 |
| **Earning (Loss) Before Interest and Taxes** | 0.00 | 0.00 |
| Interest | | |
| Taxes on income (17.5%) | 0.00 | 0.00 |
| **Net Profit (Loss)** | HK$- | HK$- |

**Approved by:** _____ _____

*Director* *Director*

**XXXX Company**

**Cash Flow Statement**
*For the Fiscal Year Ended dd / mm / year*
*(In thousands of Hong Kong Dollars)*

| | Current Year | Last Year |
|---|---|---|
| **Cash Flows from Operating Activities** | | |
| *Cash Inflows* | | |
| Cash received from customers | | |
| *Cash Outflows* | | |
| Cash paid for merchandise | | |
| Cash paid for wages and other operating expenses | | |
| Cash paid for interest | | |
| Cash paid for taxes | | |
| Other | | |
| **Net Cash Inflows (Outflows) from Operating Activities** | 0.00 | 0.00 |
| **Cash Flows from Investing Activities** | | |
| *Cash Inflows* | | |
| Cash received from sales of fixed assets | | |
| Cash received from disposition of business segments | | |
| Cash received from collection of notes receivable | | |
| Other | | |
| *Cash Outflows* | | |
| Cash paid for purchase of capital assets | | |
| Cash paid to acquire items not related to operations | | |
| Other | | |
| **Net Cash Inflows (Outflows) from Investing Activities** | 0.00 | 0.00 |
| **Cash Flows from Financing Activities** | | |
| *Cash Inflows* | | |
| Cash received from issuing stocks | | |
| Cash received from long-term borrowings | | |
| Other | | |
| *Cash Outflows* | | |
| Cash paid to repurchase stocks | | |
| Cash paid to retire long-term debt | | |
| Cash paid for dividends | | |
| Other | | |
| **Net Cash Inflows (Outflows) from Financing Activities** | 0.00 | 0.00 |
| *Increase (Decrease) of Cash During the Period* | 0.00 | |
| *Cash Balance at the Beginning of the Period* | 0.00 | |
| **Cash Balance at the End of the Period** | HK$- | HK$- |

**Approved by:** _____ _____

*Director* *Director*

### Financial Performance Indicators

***Short Term Financial Indicators***

- Current Ratio –
- Quick Ratio –
- Inventory Turnover –
- Net Working Capital –
- Current Liabilities to Inventory Ratio –
- Cash Ratio –
- Operating Ratio –
- Advertising Expense to Sales ratio –

***Long Term Financial Indicators***

- Fixed Assets Turnover Ratio –
- Total Assets Ratio –
- Assets to Equity Ratio –

***Short Term (ST) and Long Term (LT) Capital Raising***

- Debt to Sales Ratio (ST) –
- Earnings to Sales Ratio (ST) –
- Interest Coverage Ratio (ST) –
- Total Debt Ratio –
- Debt Equity Ratio –
- Long Term Debt Equity Ratio (LT) –

***Performance***

- Return on Assets Ratio –
- Return on Equity Ratio –
- Profit Margin Ratio –

### Template 4.2: KPI Matrix Template

Please download the Template at the following website:
http://www.hkiod.com/eng/publication_highlight.asp

### Key Performance Indicators

Author: *Author name*

Date: *Date created*

Version: *Version number*

## METRICS/KPIs (Sample)

| Business Unit | Stakeholder | Driver | Analytics | KPI Category | Reporting Categories | Attributes | Consolidated Metric ID | Metric ID | Metric | KPI Type | Source Of Metric | Metric Definition | Metric Calculation | Metric Dimensions | Lowest Level Of Time | History | Listed On Report/Alert/ Dashboard | Primary User Group | Data Element/ Hierarchy | Comparison |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| <Enter the business unit where the metric is applicable> | <Provide the resources from within the organization that will ultimately validate and approve the KPIs and supporting metrics> | <Provide the Business Driver name> | <Provide more information on business driver such as "financial projections", "financial projection comparison to current period", "financial projection comparison to previous period", "financial projection comparison to previous year", and so forth> | <Describe the corresponding business driver (ex. Financial Accounting> | <Describe reporting category associated with the business driver (ex. Operating Expenses, Cost, Revenue, Sales Organization Geography, Channel, Business Unit> | <Describe attributes associated to the driver (such as Territory, Company Code, Profit Center, Inventory, Sales Organization, and so forth.)> | <Diff consolidated list of metric ID> | <diff to identify this in a metric> | <To what metric does this driver belong to like Year over Year Revenue Growth, Quarter over Quarter Revenue Growth> | <The type of KPI like Early Warning, Lagging, performance indicator> | <Possible source of the metric> | <Provide definition of the metric like Net Sales Revenues for this quarter compared to Net Sales Revenues for previous quarter by region> | <Provide information on how this metric is to be calculated> | <Provide information on what dimensions this Metric is analyzed. Dimensions may be congruent with attributes> | <Time dimension on which this metric can be analyzed at the lowest level of granularity (ex. Month, Quarter, Year)> | <What historic data will be provided for comparison for this driver (Ex. Previous Year Actuals, Last Year Plan)> | <Describe the dash board or variance analysis report that this driver needs to be available> | <Primary User group> | <Data Element and Hierarchy> | <Comparison with other details like market value, product line and so forth> |

## 5. Further Readings/References


- Andy Neely. “Business Performance Measurement: Theory and Practice.” 2002.
- David Parmenter. “Key Performance Indicators (KPI): Developing, Implementing, and Using Winning KPIs.” 2007.
- Terry Wireman. “Developing Performance Indicators for Managing Maintenance Second Edition”. 2005.
- Mehta, Maneesh. “Future signals: how successful growing companies stay on course.” Ivey Business Journal, 2005.

# EVALUATION QUESTIONNAIRE

*Thank you for your interest in "SME Corporate Governance Toolkit – From Guidelines to Implementation".*

*The Hong Kong Institute of Directors aims to provide SMEs with a tool to lead the strategic planning and management of their businesses, thus strengthening their corporate governance and enhancing their capability to meet the challenges of the competitive world. It will be appreciated if you would kindly take a moment to complete this "Evaluation Questionnaire" and to return it to the Institute by fax or by mail. Thank you very much for your support.*

香港董事學會
The Hong Kong Institute of Directors

**********

To: The Hong Kong Institute of Directors Fax No: 2889 9982 For Inquiry, Tel No: 2889 9986
2104 Shanghai Industrial Investment Building, 48 Hennessy Road, Wan Chai, Hong Kong

***(Please select the appropriate boxes with √ and specify relevant information.)***

| **PART A: Evaluation of Toolkit** | Strongly agree | Agree | Neutral | Disagree | Strongly disagree |
|---|---|---|---|---|---|
| 1. I found the substance of the following chapters useful: | | | | | |
| 1. Establish Board of Directors and Committees | ☐ | ☐ | ☐ | ☐ | ☐ |
| 2. Develop the Right Corporate Culture and Leadership Style | ☐ | ☐ | ☐ | ☐ | ☐ |
| 3. Develop Business Objectives and Strategies | ☐ | ☐ | ☐ | ☐ | ☐ |
| 4. Enhance Decision Making | ☐ | ☐ | ☐ | ☐ | ☐ |
| 5. Enhance Organizational Structure | ☐ | ☐ | ☐ | ☐ | ☐ |
| 6. Enhance Human Resources Management | ☐ | ☐ | ☐ | ☐ | ☐ |
| 7. Manage Risk | ☐ | ☐ | ☐ | ☐ | ☐ |
| 8. Understand Basic Internal Controls | ☐ | ☐ | ☐ | ☐ | ☐ |
| 9. Develop Policies and Procedures | ☐ | ☐ | ☐ | ☐ | ☐ |
| 10. Develop Code of Conduct | ☐ | ☐ | ☐ | ☐ | ☐ |
| 11. Develop Disaster Recovery Plan | ☐ | ☐ | ☐ | ☐ | ☐ |
| 12. Communicate with Stakeholders | ☐ | ☐ | ☐ | ☐ | ☐ |
| 13. Attract Capital and Debt Finance | ☐ | ☐ | ☐ | ☐ | ☐ |
| 14. Develop Financial Statements | ☐ | ☐ | ☐ | ☐ | ☐ |
| 15. Develop Management Reporting Package | ☐ | ☐ | ☐ | ☐ | ☐ |
| 16. Develop Budgets | ☐ | ☐ | ☐ | ☐ | ☐ |
| 17. Develop Performance Indicators | ☐ | ☐ | ☐ | ☐ | ☐ |
| 2. I found the organisation of contents of the Toolkit appropriate for understanding | ☐ | ☐ | ☐ | ☐ | ☐ |
| 3. I found the language of Toolkit reader friendly | ☐ | ☐ | ☐ | ☐ | ☐ |
| 4. Other comments on the Toolkit *(Please specify):* | | | | | |

## PART B: Background Data

1. ☐ My business belongs to the category of SME.
2. My business is: ☐ non-manufacturing business ☐ manufacturing business
3. My business size is as follows:
   Number of employees in Hong Kong: ☐ 1-10 ☐ 11-20 ☐ 21-50 ☐ 51-80 ☐ 81-100 ☐ >100
   Number of employees elsewhere: ☐ 1-10 ☐ 11-20 ☐ 21-50 ☐ 51-80 ☐ 81-100 ☐ >100
   Number of Board Members: ☐ <3 ☐ 3-5 ☐ 6-10 ☐ >10
4. My business belongs to the following industry/profession:

| √ | Industry/Profession Type | Code | √ | Industry/Profession Type | Code |
|---|---|---|---|---|---|
| ☐ | Academic, Education Services | 0100 | ☐ | Legal Services | 1300 |
| ☐ | Accountancy Services | 0200 | ☐ | Manufacturing | 1400 |
| ☐ | Architectural, Building, Construction Engineering, Surveying | 0300 | ☐ | Marketing, Advertising, Event Management | 1500 |
| ☐ | Arts, Culture, Entertainment | 0400 | ☐ | Medical, Healthcare | 1600 |
| ☐ | Banking, Financial Services, Investment | 0500 | ☐ | Property: Developer, Agency, Manager | 1700 |
| ☐ | Business and Management Services | 0600 | ☐ | Recreation, Sports | 1800 |
| ☐ | Catering, Hotel, Tourism | 0700 | ☐ | Retail | 1900 |
| ☐ | Communications, Publishing | 0800 | ☐ | Security, Safety | 2000 |
| ☐ | Statutory, Trade & Professional Bodies | 0900 | ☐ | Trading | 2100 |
| ☐ | Human Resources: Search, Training | 1000 | ☐ | Transport, Logistics | 2200 |
| ☐ | Insurance | 1100 | ☐ | Utilities | 2300 |
| ☐ | Information Technology | 1200 | ☐ | Welfare & Social Services | 2400 |
| ☐ | Others *(Please specify):* | | | | 9000 |

5. ☐ My business is related to providing SMEs with advice and counsel.
6. I first came to hear about the Toolkit from:

| | | | |
|---|---|---|---|
| ☐ | The Hong Kong Institute of Directors | ☐ | Other government or related organizations |
| ☐ | Trade and Industry Department | ☐ | Media |
| ☐ | Hong Kong Productivity Council | ☐ | Library |
| ☐ | Other sources *(Please specify):* | | |

## Part C: Request for Information

☐ I am interested in the membership and activities of The Hong Kong Institute of Directors.
Please send me more information.

Addressing title: Mr/Ms/Mrs/Dr/_____

Name in Chinese if applicable: _____

Name in English: _____

Company: _____

Position: _____

Correspondence address: _____

_____

Tel No: _____ Fax No: _____ Email: _____

香港董事學會
The Hong Kong Institute of Directors

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The Hong Kong Institute of Directors

# Significant Values of HKIoD Membership

# 作為香港董事學會會員的肯定意義

- Availability of Continuing Professional Development programmes and up-to-date information on director practices.
- Participation in, and contribution to, a collective voice on corporate governance issues in order to help shape the future of Hong Kong.
- Recognition as a member of a progressive premier body representing professional directors.
- Networking opportunities with fellow members and associate bodies in the local community, Mainland China and overseas.
- Friendship in a multi-cultural international environment.
- Enjoyment of various members' benefits offered by HKIoD and reciprocal entitlements from kindred organisations.

- 獲得持續專業發展培訓及有關董事實務趨勢的最新資訊。
- 參與對有關企業管治重要問題的詳細研究、徵集意見、敲定建議，然後向有關當局作出代表性的反映，以協助創建香港的未來。
- 獲認可為一富進取精神、代表專業董事的精英組織一份子。
- 伸展網絡至來自各門專業及行業的會友、本地的友好專業團體、以至中國內地和海外的同類組織。
- 在多元文化的國際環境下拓展友誼。
- 分享本會的各種會員福利及世界各地相屬組織的互惠服務。