GUIDANCE NOTE

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KING V - APPLICATION TO SMALL AND MEDIUM ENTERPRISES

CONTENTS

INSTITUTE OF DIRECTORS SOUTH AFRICA

KINGV™

Introduction

This guidance applies to small and medium enterprises (SMEs) which operate as private for-profit companies with a public interest score typically ranging between 350 and 500, calculated in terms of Regulation 26(2) of the Companies Act. The lower score reflects the point at which certain governance obligations, such as the appointment of an auditor, become required. The upper score reflects the threshold beyond which companies may start being considered large private companies, and thus likely to apply the King recommended practices more fully.

While the King V Code on Corporate Governance (the Code) is designed to be applicable across all organisations, its application to SMEs requires contextual interpretation. This is due to the reduced size, complexity and impact compared to larger companies.

SMEs typically start from a founding member(s) investing energy, passion and resources over time with the enterprise growing sometimes over decades and generations, to eventually become a company owned by several outside shareholders. SMEs are often family businesses.

The risk with SMEs is that the governance structures and processes do not evolve and mature as the company does. It is therefore important to ensure that a good governance foundation is established from the beginning to ensure it is carried forward and entrenched in the way in which business is conducted. "Governance is thus a long-term commitment that takes time to develop and build momentum and demonstrate clear value. Over time, each year of governance builds upon the last and creates a stronger company".[1]

A key consideration in the development of corporate governance in tandem with the growth and strategic objectives of the organisation is the transition of ownership and management. "Business growth ultimately requires an evolution from an entrepreneurial to a professionally managed organisation system."[2]

This guidance paper provides a detailed interpretation of the Code as it applies to SMEs, outlining key nuances, points of emphasis and other considerations that affect the practical implementation of each King V principle.

[1] Carl Bates, *Traversing the Avalanche: A practical guide to the implementation of effective governance for SME growth*, First Edition, 2014, page 65.

[2] Tony Balshaw, *Thrive! Making Family Business Work, 2003*, p116-117

Terminology

Term used in King V	Relevant term for SMEs
Organisation	Company or SME
Governing body	Board of directors
Members of the governing body	Directors
Shareholders	Owners or equity holders
Stakeholders	Owners, employees, customers, suppliers, financiers, regulators and the broader community affected by the SME's operations.

Typical corporate governance application considerations

The recommended practices of the Code apply to SMEs, with the following areas of emphasis or nuance.

Principle 1: Leadership

Principle 1: The board leads ethically and effectively as the focal point of corporate governance in the company.

Characteristics and values (Recommended practices 1-2)

SME directors should individually and collectively cultivate the characteristics of ethical and effective leadership and exhibit them in their conduct. As leadership in SMEs is often concentrated in a few individuals, their personal conduct and decision-making set the tone for the organisation's ethical culture and values.

Dimensions of governance obligations (Recommended practices 3-5)

Despite the often-informal nature of an SME, there is a need to put corporate governance on a formal footing and a key element of this is recognition of the board's overarching leadership and governance role. These recommended practices provide a guideline to these governance obligations for SME boards. It is, for example, important for an SME board to have a board charter as per the practice recommendations in the Code to outline its governance role and differentiate it from management and the day-to-day operations that many directors will also be involved in.

Performance evaluation of the board (Recommended practices 6-9)

The evaluation of the performance of the board, its members and committees should be applied to SMEs proportionally and practically. For many SMEs, a simple, informal meeting for reflection around what is working and what the shortcomings of the board are may be sufficient. As the business grows, more structured approaches could be adopted. Regardless of the formality, the results of the performance evaluations should be addressed by the board of the SME to achieve continued improvement in its performance and effectiveness.

Principle 2: Ethics

Principle 2: The board governs the ethics of the company in a way that enables an ethical culture and responsible corporate citizenship.

Organisational ethics (Recommended practices 10-14)

While SMEs may not have the scale or resources to implement formal ethics management systems, it is essential that ethical conduct is actively embedded in daily operations. A code of conduct, clear values communicated by the founders or directors, and periodic reflection on ethical risks are practical ways for SMEs to uphold these recommended practices. Over time, as the SME grows, more formalised processes may be introduced.

Responsible corporate citizenship (Recommended practices 15-18)

Due to the important role of SMEs in fostering an inclusive, growing economy and societal transformation, they are integral to society. SMEs also form part of the supply chain of other larger organisations.

Being a responsible corporate citizen is often critical to the growth and long-term success of SMEs. Earning the trust of customers, employees, communities, providers of capital and other stakeholders builds credibility, opens market opportunities and supports access to funding and partnerships. Without this trust, SMEs risk undermining their sustainability and limiting their potential to grow into larger, resilient enterprises. Implementing these recommended practices proportionally as the SME grows is thus appropriate.

Principle 3: Strategy, performance and sustainable value creation

Principle 3: The board ensures that the company's purpose, strategy and business model support performance that creates sustainable value within the company's economic, social and environmental context.

Strategy, performance and value creation (Recommended practices 19-22)

The recommended practices under this principle address the development and approval of the organisation's strategy, implementation thereof and organisational performance. SMEs should consider both the opportunities and risks arising from their operational environment when formulating strategy. As regards performance, they should monitor the effect their business has on the economy, the environment, society, as well as the capitals they use or affect. By understanding the connection between sustainability and the business, an SME can measure its business performance, identify the risks and opportunities emanating from its chosen strategy and manage change effectively. This will drive performance and innovation within the SME.[3]

Principle 4: Reporting

Principle 4: The board ensures that external reports issued by the company enable stakeholders to make informed assessments of how the company creates, preserves and erodes value within its economic, social and environmental context over the short, medium and long term.

Reporting (Recommended practices 23-27)

Reports are a powerful means for SMEs to communicate meaningfully with stakeholders, such as shareholders, customers and potential providers of financial capital. Good corporate governance is often a precondition for obtaining funding and is a key consideration for investors assessing whether to invest in an SME. Transparent, accurate and timely reporting helps build trust and credibility, which can open doors to growth opportunities and partnerships.

Reports that are underpinned by integrated thinking and that present information about the resources and relationships on which the SME relies and affects, its activities, outputs and outcomes in an integrated manner, are an effective way of informing stakeholders about the SME's performance.

[3] Adapted from: Global Reporting Initiative, *GRI Ready to Report? Introducing sustainability reporting for SMEs booklet* (2014) available at https://www.globalreporting.org/resourcelibrary/Ready-to-Report-SME-booklet-online.pdf

However, the nature and extent of reporting by SMEs would be proportional to their size, complexity and stakeholder expectations. Typical reports may include annual financial statements, a basic operational overview, and where relevant, updates on strategy or key risks to shareholders or financiers.

As an SME grows, it should work towards issuing an integrated report. Other reports like sustainability reports, remuneration reports or social and ethics committee reports may also become applicable. The recommended practices under this principle should be interpreted with this in mind to support the SME's reporting responsibilities. Any SME that wishes to claim application of King V must disclose their implementation using the King V Disclosure Framework.

Principle 5: Composition of the board

Principle 5: The board ensures that its composition is balanced with respect to the mix of competencies, diversity and independence that enables it to discharge its obligations objectively and effectively.

Composition (Recommended practices 28-33)

Having a mix of executive and non-executive and one or more independent directors on the board also assists to mitigate the risk that emotive issues drive decision-making, especially in family companies or where the authority of the founding member is entrenched.

In order to ensure that there is a balance of power, it is good practice for the non-executive directors to be rotated on a regular basis so as to maintain the independence value that a non-executive provides. For an SME, too regular rotation may not be practical or feasible (especially if the SME only has one or two non-executive directors) and thus non-executive directors of SMEs may serve for longer periods than in larger companies.

Because the roles of director, manager and shareholder are often shared in SMEs, it creates a greater dependency on key individuals. Succession planning for directors and managers should be put in place to ensure that key positions can be filled temporarily on an emergency basis. Succession planning should also provide for a process for permanent succession. This is often a challenge in SMEs and affects business growth and continuity from one generation to the next if not dealt with effectively.

An effective succession plan cannot be developed overnight but requires deliberate and well-thought-out processes which are tested and considered over time. "Criteria should be developed for the successors.

This plan should describe, inter alia, how the successor will be chosen, what kind of skills and experience will be required, what training and grooming will be necessary and how it should be obtained."[4]

Nomination, election and development of board members (Recommended practices 34-37)

Many SMEs do not typically have a separate nominations committee to deal with the selection and nomination of new directors for appointment. It is thus recommended that some guiding practices be documented that set out a simple nomination, selection and appointment process, the skills and qualifications required from directors and any other specific criteria that need to be met for directors to be eligible for appointment. Once the SME has grown to the extent that there are a number of non-executive directors serving on the board, a more formal nominations process could be set up.

Directors of SMEs, especially those who are not experienced non-executive directors, should undergo rigorous inductions and corporate governance training so that they are adequately equipped to fulfil their duties.

Independence and conflicts (Recommended practices 38-44)

Having independent directors may pose a challenge to SMEs due to capacity and resource constraints. Nevertheless, input free from perceived and actual bias adds value to board deliberations and serves as an added check. Therefore, SMEs could consider inviting an experienced and competent person to serve as a non-executive and ideally as an independent director. If this is not feasible, such a person may be consulted on an ad hoc basis and invited to attend board meetings in an advisory capacity as and when necessary to obtain objective input until such time as the SME is in a position to appoint an independent non-executive director. Such an advisor should be engaged contractually to avoid the risk of the person being deemed a director, and to protect the confidentiality undertakings and discussions. This initial step should evolve as the organisation grows in capacity, resources and consequently impact to include a number of non-executive board members and at least one independent board member who serves as chairperson.

Conflicts of interest are a common governance risk in SMEs, particularly where directors are also shareholders, managers and maybe family members. To ensure objective decision making, boards should adopt a conflict of interest policy that requires disclosure of any personal, financial or relational interests that could influence judgment. Even in smaller enterprises, documenting and transparently managing conflicts builds trust with stakeholders.

[4] Tony Balshaw, *Thrive! Making Family Business Work, 2003*, p114

Chairperson and lead independent member of the board (Recommended practices 45-50)

In the early stages of an SME, the role of chairperson is often fulfilled by the founder or an executive director. As the company grows, it is recommended that the roles of CEO and chairperson be separated to ensure better role clarity that separates governance and management functions and improves checks and balances. Ideally, over time, the chairperson should be a non-executive director and eventually an independent non-executive director. Even in smaller boards where separation is not immediately feasible, the individual performing the chairperson's role should consciously adopt a facilitative and objective leadership style, ensuring inclusive deliberation, accountability and balanced decision making.

The role of lead independent is typically not applicable to SMEs in their early stages due to the limited number of directors and the absence of a significant number of independent non-executive directors. However, as the SME grows in size, complexity and governance maturity—especially if it begins to attract external investors or expand its board—consideration could be given to appointing a lead independent to strengthen oversight and improve governance.

Principle 6: Committees of the board

> **Principle 6: The board ensures that arrangements for delegation to committees and individuals within its own structures promote the objective and effective discharge of its obligations.**

Committees of the board (Recommended practices 51-75)

Due to capacity and resource constraints, it may not be possible or necessary for an SME to have any or all the board committees as recommended in the Code. In such cases, the board retains full responsibility to ensure that it addresses those matters which a board committee would have otherwise addressed. If this is the case, agendas should be appropriately structured or, if necessary, separate meetings should be set up to ensure sufficient focus on all necessary domain areas.

Generally, the board would need to consider forming committees or delegating tasks to certain board members when the complexity increases or when it is unable to cope with the workload and when insufficient attention and deliberation is being dedicated to specific elements of the business. This normally manifests itself in extremely long board meetings or not being able to dedicate sufficient quality time to all matters on the agenda.

As the SME matures and the board expands, it may gradually introduce standing or ad hoc committees aligned to those recommended the Code, starting with those that address higher-risk areas.

Principle 7: Appointment and delegation to management

Principle 7: The board ensures that the appointment and delegation to management promote operational effectiveness and that the respective roles and decision-making powers of the board and management are clearly defined.

CEO appointment and role (Recommended practices 76-80)

In many SMEs, especially in their early stages, the same individuals often perform the roles of directors, owners and managers. As the SME grows, this separation of roles and responsibilities should be formalised, with a view to eventually appointing a CEO who reports to the board.

Delegation to management (Recommended practices 81-83)

While the delegation to management in SMEs may be simpler and less extensive than in larger organisations, it should still be formalised — even if documented in a brief letter, one-page statement or similar format.

It is good practice for the board to clearly distinguish when it is acting in a governance capacity and when its members are performing operational management duties. For example, board meetings could be scheduled separate from management meetings with appropriate agendas, even though the same persons may be involved in both meetings (e.g. the board meets quarterly to strategise and monitor trends while management meet monthly and analyse operational detail).

Reducing a description of each of these roles to writing will further assist shareholders, directors and management to identify when they should be acting in which capacity especially when specific authorities are exercised. It is recommended that an SME signs a shareholders' agreement (even if all shareholders are related) and incorporate in this agreement a board charter and a delegation of authority to allow management to run the organisation on a day-to-day basis.

Professional corporate governance services to the board (Recommended practices 84-90)

With regard to administrative and governance support, SMEs are typically not required to appoint a company secretary, and doing so is likely not feasible. However, it is recommended that as the SME grows, the board ensures access to:

- A board administrator (internal or external) to support the coordination of meetings and record-keeping.
- Independent professional governance guidance (whether internal or external), particularly as the organisation grows in complexity and governance requirements increase.

Principle 8: Risk

Principle 8: The board governs risk in a way that enables the company to sustain and optimise its strategy and objectives.

Risk (Recommended practices 91-94)

While SMEs may not have a formal risk function and policy, the board remains responsible for ensuring that significant risks and opportunities—financial, operational, legal and reputational—are identified, documented, assessed and addressed.

A basic risk register and regular review of key risks at board meetings, typically included as part of the CEO's report, can help embed risk oversight in the early stages of the SMEs lifecycle, with further development as it grows.

Principle 9: Compliance

Principle 9: The board governs compliance with applicable laws and adopted policies, non-binding rules, codes and standards in a way that promotes ethics and responsible corporate citizenship.

Compliance (Recommended practices 95-99)

While compliance may be less complex than in larger organisations, the board should ensure it is aware of applicable laws and industry requirements, and that the SME takes appropriate steps to remain compliant.

Where needed, SMEs may rely on external service providers or advisors for compliance support to achieve the objectives of this principle. As the SME grows, its compliance function and policy could develop further.

Principle 10: Data, information and technology

Principle 10: The board governs data, information and technology in a way that enables the company to sustain and optimise its strategy and objectives.

Data, information and technology (Recommended practices 100-110)

Data, information and technology are often critical enablers of growth and competitiveness for SMEs.

The board should ensure that appropriate systems and controls are in place to protect business information, support decision-making and manage key technology risks. This includes things like data security, access controls and reliable backup systems. The board should also adopt simple, fit-for-purpose policies that guide how data, information and technology are governed — such as acceptable use, data protection and cybersecurity practices — which can evolve and mature as the organisation grows in scale and complexity. As the SME grows, the board should also review the alignment of its technology choices with its strategic objectives and risk profile and formalise its oversight structures.

Principle 11: Remuneration

> **Principle 11: The board ensures that the company remunerates fairly, responsibly and transparently to promote sustainable value creation by the company within the economic, social and environmental context.**

Remuneration (Recommended practices 111-118)

While SMEs are generally not required to disclose remuneration publicly, the board should ensure that remuneration practices are fair and aligned with the SME's financial position, performance and long-term objectives.

Clear documentation of remuneration arrangements—particularly for directors, managers and family members that may be involved in the business—helps to avoid misunderstandings and perceptions of unfairness. As the SME grows or seeks external funding, more formal remuneration governance may become appropriate.

Principle 12: Assurance

> **Principle 12: The board ensures that assurance functions and services promote an effective internal control environment and safeguard the integrity of external reports issued by the company.**

Assurance (Recommended practices 119-131)

SMEs that are companies may be subject to different levels of external assurance (audit or independent review) depending on their public interest score, as set out in the Companies Act Regulations.

While SMEs seldom have internal audit functions in their early stages, the board should still ensure that key controls are functioning effectively. As the business grows, it may consider appointing outsourced professionals to provide ad hoc assurance over specific risk areas such as inventory, procurement or data security.

Principle 13: Stakeholders

Principle 13*:* The board adopts a stakeholder-inclusive approach in the execution of its duties in the long-term best interests of the company within its economic, social and environmental context.

Stakeholder relationships (Recommended practices 132-136)

SMEs have important stakeholders—such as employees, suppliers, lenders, key customers, communities and in certain instances regulators—whose interests should be acknowledged and managed in a fair and transparent manner. The stakeholders' material needs should be identified, assessed, and the appropriate engagement implemented to ensure the continuity of the business, aligned with these recommended practices as the SME grows.

Shareholder engagement (Recommended practices 137-144)

Due to the nature of an SME, shareholders may be more involved than is the case with bigger companies. With family businesses, shareholders may also have personal ties with managers, executives and directors, which necessitate communication structures that bridge family and business matters.

Due to the relational proximity of shareholders to the organisation, there should be agreement between the organisation and shareholders on policies for future equity ownership. Such policies should deal, for example, with the transfer, acquisition and disposal of shares in the SME, including the method of valuing shares equitably.[5] These recommended practices should thus be applied proportionately in this context.

An SME is generally not required by law to hold an annual general meeting, unless specified in its memorandum of incorporation. Nevertheless, it is good governance for SMEs to create structured opportunities for shareholder engagement (as they grow), thereby creating a separation between ownership and control to ensure transparency, alignment on strategy and accountability of the board.

Relationships within groups of organisations (Recommended practices 145-150)

The recommended practice in the Code relating to relationships within groups of organisations is generally not applicable to SMEs, as they seldom form part of larger corporate groups with complex interrelationships. In the rare cases where an SME is part of a group structure, the board should consider the recommended practices in terms of the governance arrangements across the group and ensure alignment in key areas, while still exercising its independent responsibilities for the SME itself.

[5] Tony Balshaw, *Thrive! Making Family Business Work, 2003*, p123

Conclusion

For SMEs, governance strengthens internal controls, supports long-term sustainability, builds stakeholder confidence and can improve access to finance and markets. Sound governance practices can also help SMEs manage risks more effectively, avoid disputes and support ethical leadership and decision-making.

While SMEs may not have the same public accountability or resources as larger entities, the proportional application of King V enables them to adopt sound governance practices appropriate to their size, nature and complexity. As SMEs evolve, they should progressively deepen their governance practices.