SmartLessons
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Be Smart in Selecting Your Clients: The First Step May Define Your Whole Project

To prepare an excellent meal, you start by choosing the best ingredients. Similarly, successful corporate governance projects need to select well-suited clients. The goal of IFC's corporate governance projects is to improve the clients' corporate governance practices, thereby helping them operate more effectively and allowing them easier access to capital. This SmartLesson provides lessons learned during the Pilot Program, one of the many activities undertaken by the Georgia Corporate Governance Project. As we worked to improve the corporate governance practices of Georgian companies and banks, we discovered—or rediscovered—the value of careful client selection.

BACKGROUND

As the name implies, the Pilot Program works with select companies and banks to create a model of best practices of corporate governance. During the Pilot Program, the project team conducts a full-scale corporate governance assessment of the client. This in-depth assessment consists of a review of the client's corporate documents, and numerous face-to-face interviews with its supervisory and management boards and its personnel. The project delivers to the client an assessment report and recommendations, and helps with the implementation of recommended improvements. The goal of the program is to replicate the best corporate governance standards, on a smaller scale, for one company in order to demonstrate its effects for other companies and for the public at large. Positive results for the pilot company, such as the attraction of investments, not only have significance for that company, but through a demonstration effect, these results are important for the entire market as well.

LESSONS LEARNED

1) Selection of the right candidate is critical to achieving good results in the Pilot Program—and making the pilot company a real model for other companies.

The main criteria for candidate selection are:

- The candidate should be committed to making changes to improve its corporate governance practices.
- To have a demonstration effect, the candidate should have a good market image and reputation.
- The ownership structure of the candidate should not have significant state or foreign investment.[8]
- The candidate should have a realistic development program for potential investment.

Even though the pilot candidate should comply with all four of these criteria, the first one has the most important role in final success, because it requires that the management, the supervisory boards, and the large shareholders truly aspire to improve corporate governance at the company.

2) Commitment to improving corporate governance should come from the company itself—not from just one person in the company, even if it's the most key person.

The most common corporate governance problem in Georgia, as in many former Soviet countries, is the vertical (top-down) decision-making process, in which only a few people—or even just one person—

can make key decisions for the company. In the short term, dealing with this arrangement may be expedient, since you don't need to negotiate with or persuade many different players on the advantages of good corporate governance, and one person can move the process forward faster. But in the longer term, this management style has a disadvantage, because it develops bureaucratic procedures and practices that can slow down the whole process and increase the risk of errors in decision making.

In the case of the GCGP, one of our pilot candidates was a successful bank, well known by businesses and the public, and one of the biggest employers in Georgia. It was the seventh-largest bank in Georgia by asset size and one of the leaders in the banking sector, as measured by the number of customers and its branch network. The bank also wanted to attract foreign investment, and it understood the importance of good corporate governance to attract new investments. A successful pilot program might have a strong demonstration effect and would help increase the awareness of good corporate governance in the sector and country.

However, the decision to participate in the Pilot Program, as with almost all decisions in that bank, was made solely by the chief executive officer, who was a corporate governance champion in the company. The chair of the supervisory board agreed with this decision, but she did not know any details since she had a very passive role in the bank's operations. The concentration of decision-making power in one person was so high that even minor actions or decisions could not occur without the CEO's notice. For example, it was impossible for our team to receive the necessary initial corporate documentation from the bank, or to set up an interview schedule with members of the supervisory and management boards and people in other key positions without prior permission from the CEO. This concentration of decision-making authority in one person made it extremely difficult for our project to begin the pilot program.

The candidates should commit to changes that will improve their corporate governance practices.

After completion of the selection procedure, and right before the Pilot Program was to begin, the CEO was elected to Parliament and had to resign from his position at the bank. This turn of events has delayed the launch of the program because the other members of the management board, who were used to the situation in which the former CEO made all the decisions, were not able to decide on their own to move ahead with the project. Given these circumstances, we could not go forward with this candidate at the time, and a year later we are still waiting for management to reorganize and show a stronger commitment to improving its corporate governance.

3) Diversify the risk by working with several pilot candidates—not just one.

During the selection process for the pilot, it is important not to put all your eggs in one basket. For instance, relying on just one specific contact within a company might be risky for the project. But it is also risky for the pilot to rely on just one candidate company, as illustrated by our experience with the bank that lost its CEO. Always work and negotiate in parallel with different pilot candidate companies, to diversify the risk of process interruption.

In our case, even before the CEO left, the concentration of decision-making power within the bank was so high that it harmed the project to some extent, because it

caused us to spend much effort and time on a bank that did not become an active client. If the bank had been the only pilot candidate for the project, the negative impact would have been much higher.

Fortunately, the project also had worked and negotiated with another pilot candidate, providing consultations and workshops to both banks at the same time. These interactions gave us more confidence in assessing both clients' commitment to improve their level of corporate governance. After the failure of one pilot candidate, we immediately used our back-up plan and switched and intensified our work with the second pilot candidate. This way, we minimized the time gap and smoothly moved on to focus our attention on the other bank.

4) Be alert to indicators of pilot success or failure—signs that the candidate is (or is not) committed to good corporate governance.

Different companies have different cultures and styles of governance and management. A manager's or the chairman's behavior, attitudes, and values may say a lot about the company's corporate culture. Improvement in corporate governance practices to some extent implies changes in corporate culture. Each company has its own corporate culture, and experience tells us that changing it is quite difficult. In some cases, it has taken years for a corporate culture to develop; therefore, changing it is very time- and resource-consuming.

A seminar for microfinance organizations on "The Best Practices of Building an Effective Board of Directors."

While working with pilot companies, it is important to understand whether the specific corporate governance improvements needed also require changes in corporate culture, and whether the company is ready for such changes. Sometimes these changes involve very sensitive issues, and the company may refuse to implement them. For example, formalization of some practices or a requirement to start documenting meeting results might be understood by someone in the company as distrust. Also, the delegation of duties might imply a loss of power for some.

During the process of working with particular pilot candidates, the team should observe governance styles, behaviors and corporate cultures. For instance, they should monitor attendance at the project seminars, workshops and consultations, and pay attention to interactions within the company.

An assessment team needs to be smart and understand the clues early on during the work with the pilot candidate. Is the company ready for changes? If not, the company will not be in a position to implement recommendations for improving corporate governance, and continuing with that candidate will not be a proper use of resources.

Workshops and seminars provide opportunities for the assessment team to observe interactions within the pilot candidate company.

Experience gained through working with pilot candidates has taught us that there are definite links between corporate culture and the success or failure of a pilot program. The table lists some signs to look for when evaluating a candidate's corporate culture. Disregarding these signs may have a negative impact on the final results of your pilot program.

CONCLUSION

Selection of candidates is the first step in a corporate governance project's pilot program, and it may determine the success or failure of the entire project. So be smart in selecting your clients! The most common corporate governance problem with companies in

THINGS TO LOOK FOR IN EVALUATING A PILOT CANDIDATE'S CORPORATE CULTURE

Negative Signs	Positive Signs
Delays in providing information	Information provided on time
Difficulty setting up meetings with top management	Top management always ready to meet with the project staff
Unwillingness of the chairman and other members of the supervisory board to attend seminars or workshops	The chairman and other members of the supervisory board regularly attend seminars or workshops
Difficulties reaching and communicating with the CEO	Direct communication with all members of top management
Lower management not meeting with you unless top management signs off on it	Free communication with lower management
At meetings, participants asking CEO's permission to ask questions	At meetings, all participants feel free to ask questions, and feel free to disagree with top management
Lower management trying to hide problems they have in the company	Lower management discuss problems they have in the company and ways to solve them
CEO's personal secretary is afraid to contact him	

emerging markets is the top-down decision-making process, with a single individual responsible for all the key decisions—making the success of your pilot program largely dependent on that one person. That is why it is important to have a commitment from the company itself, rather than being dependent on the goodwill of just one person. Also, it is always better to diversify and work in parallel with two or more pilot candidate companies, so as to minimize the risk of process interruption if one candidate falters. Finally, be alert to the corporate cultures, attitudes and values of your pilot candidate companies, noting those positive or negative signs that often can predict the success or failure of a pilot program.

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