

IMPROVING CORPORATE GOVERNANCE OF UNLISTED COMPANIES

Introduction ■■■■

The Board of Directors of the Central Chamber of Commerce of Finland established on 18 October 2004 a working group for the purpose of studying corporate governance practices in unlisted companies.

Mr Matti Vuoria, Executive Chairman, was appointed Chairman.

The following persons were appointed members of the working group:

Mr Jaakko Gummerus, Manager Legal Affairs,

Ms Marja Hanski, Vice President, Business support,

Ms Minna Isoaho, Development Manager,

Ms Tuija Kemppainen, Director of Controller operations,

Mr Pekka Sairanen, Chief Executive Officer,

Ms Anna-Maija Simola, KHT auditor,

Mr Väinö Takala, President and CEO

Mr Veli-Matti Tarvainen, Corporate Counsel,

Ms Maarit Toivanen-Koivisto, President

Ms Leena Linnainmaa, Senior Deputy Director and Mr Pekka Salomaa, Senior Adviser were appointed permanent experts to the working group.

Ms Anne Horttanainen, Legal Counsel of the Central Chamber of Commerce of Finland, acted as secretary for the working group.

On the basis of the proposals by the working group the Board of Directors of the Central Chamber of Commerce of Finland has issued An agenda for Improving Corporate Governance of Unlisted Companies, i.e. companies which are not considered able to implement the Corporate Governance Recommendation for Listed Companies, but which nevertheless desire to improve their operations in conformity with good corporate governance principles.

Implementation of this agenda is fully voluntary. On the basis of this list companies can evaluate their own practices and determine, from their own point of view, whether they need to amend or improve their management methods and governance. The list does not compel companies to apply any certain procedures, nor to implement certain structures. Companies need not publicly give any reasons for their own corporate governance systems. No time limit is foreseen for implementing the list; companies may use it according to their own needs.

The list is divided into chapters concerning general meetings, the board of directors, the managing director, compensation systems, internal control and risk management, audit, articles of association, shareholders' agreements, redemption and approval clauses, and communication and information. Furthermore, the list contains a chapter intended for the use of family enterprises for change-of-generation purposes. In each chapter there is first a general description, then a list of questions that may serve companies in their evaluation whether sufficient attention has been paid to the matters concerned and whether the company needs to improve its corporate governance systems.

The primary purpose of the list is to serve limited companies, but the principles contained therein can be applied also in respect of other enterprise forms.

HEX Plc, the Central Chamber of Commerce of Finland and Confederation of Finnish Industry and Employers have given on December 2003 a Corporate Governance Recommendation for Listed Companies. The Central Chamber of Commerce of Finland has issued a statement in January 2006 urging the most extensive unlisted companies to follow the recommendations of the listed companies as far as possible considering the special features of these companies, in accordance with the "Comply or Explain"-principle.

An Agenda for Improving Corporate Governance of Unlisted Companies ■■■■

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General Meeting of Shareholders

The shareholders of limited companies use their decision-making powers at the general meeting. That meeting elects the company's board of directors. Shareholders' right of speech and vote also includes the right to ask questions, as well as the right to table resolutions concerning matters on the meeting's agenda.

Do the company's owners get sufficient information about the company, its organs and its auditors? Is the general meeting organized in such a manner that participation is easy for the shareholders? Do the members of the board of directors, the candidates for board membership and the managing director attend the meeting? Shall the auditors attend?

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

Arrangements for the general meeting, such as time, place and advance information, are means for giving shareholders better opportunities to attend.

Attendance of the members of the board of directors and of the managing director promotes interaction between shareholders and the corporate organs. Such attendance enables shareholders to exercise their right of asking questions. In that way shareholders can get more detailed information about matters that may have an impact on the evaluation of the company's financial statement, its financial situation, or of other matters dealt with at the general meeting.

It is preferable that a person, who for the first time is a candidate for membership of the board of directors, is presented to the shareholders at the meeting where the members are elected.

The Board of Directors

The board of directors is responsible for the administration of the company and for the appropriate management of its business. The board guides and supervises the company's operations and its managing director, it appoints and dismisses the managing director, it determines the company's goals and objectives and its risk management principles. The board ensures the appropriate functioning of the company's management system and is furthermore responsible for the supervision of the company's accounts and the administration of its finances. The duty of the board members is to promote the company's and all its shareholders' interests, irrespective of who has proposed their candidature for board membership.

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

The number of board members is determined on a case by case basis, according to the company's needs and its operational basis. Factors that have an impact on that number are inter alia the scope of the company's business and the distribution of its shares.

In companies with a wide ownership basis, or extensive business operations, the effective execution of the board's duties may require more members of the board. On the other hand, if the same person is both owner and manager, only one ordinary member of the board and one deputy are sufficient in most cases.

Do all members of the board of directors get sufficient and equitable information about the company? Are the board members sufficiently well acquainted with the company's business?

For the execution of their duties the members of the board of directors need information about the company's structure, business and markets.

Initiation of new board members to the company's business operations and good information to all board members in that respect promote efficient management by the board of directors. Sufficient and equitable information is important to enable the board to operate well, in particular for those board members who are not officials of the company or its shareholders.

Does the company's board of directors have rules of procedure? Are those rules and the areas of responsibility of the board members set out in writing? Does the chairperson of the board lead it efficiently and does the board work in an effective manner?

Effective conduct of the board's business can be promoted by defining its essential duties and operational principles in its written rules of procedure. Those rules may for example contain provisions on the job distribution between the board members, the frequency of board meetings, the extent to which deputy members are involved in the board's work and how the board members are invited to meetings.

The activity of the chairperson of the board greatly affects the entire board's effective fulfilment of its duties and ensures that the board makes use of its expertise for the benefit of the company. The chairperson is responsible for leading the board of directors and also for communicating the shareholders' views and opinions to all members of the board. The chairperson's activity is also important for providing the board members with supplementary information about the company on a continuous basis.

The work of the board of directors can be improved by ensuring that all members are sufficiently and equitably informed about the company and the matters on the agenda in good time before meetings, that meetings are well prepared, that the agenda is appropriately scheduled and that there is an open and communicative atmosphere at the meeting.

Minutes shall be made concerning board meetings. Minutes shall be numbered in

running order and shall be stored reliably. It shall be possible to verify the board's decisions afterwards.

Do the board members have sufficient time to carry out their duties on the board, in addition to their other engagements? Is the composition of the board sufficiently diversified? What are the strong and the weak points of the board? What further expertise and experience could be obtained to make the board more effective in the future? Could the board's conduct of business be improved by electing one or several board members who do not beforehand have any close relations with the company? Is the board's work evaluated by the board itself, or by an outside appraiser?

When electing members of the board of directors it should be ensured that the candidates have the possibility to attend to company business to a sufficient extent. Board members, and particularly the chairperson, are also required to work between meetings. Questions such as board members' main and ancillary occupations, and their parallel seats on other boards of directors, are the factors which help evaluate whether board members have sufficient time to carry out their duties.

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

It is the duty of the board of directors to guide and to monitor the company. By appointing persons who do not previously have any close

relations to the company it is possible to improve the board's conduct of business for the benefit of the company and for all its shareholders.

The effectiveness of the board's work can be evaluated by regular monitoring of its conduct of business and its working methods. That evaluation can be made either as self-evaluation or by using external appraisers.

Are the members of the board aware of the legal liabilities involved in their work?

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

The Managing Director

The company may have a managing director. The board of directors appoints and may dismiss the managing director. The managing director administers the company's day-to-day business according to orders and instructions issued by the board of directors. Taking account of the extent and the character of the company's business, the managing director may take measures having exceptionally unusual and extensive implications only upon authorization by the board of directors. The managing director shall ensure the conformity with the law of the company's accounts and of the reliable organization of its financial administration.

The managing director shall give the board of directors and its members all information needed to carry out the board's duties. The managing director is independently responsible for discharging the duties within his or her job area.

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

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

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

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

The Companies Act permits the election of the managing director as chairperson of the board of directors. However, a differentiation of duties seems natural, because one of board's duties is supervision of the managing director. Decision-making powers are not excessively concentrated in the hands of only one person, if the scope of the managing director's and the board's chairperson's responsibilities are clearly differentiated.

The managing director shall give the board of directors all information that the latter needs for fulfilling its tasks. If needed, the board of directors determines what information it shall have.

The company ought to have plans for a successor and for somebody to temporarily take over the managing director's tasks and responsibilities for the eventuality that there is a change of managing director.

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

The management group has no official position under company law, but on practical level it may play an important role in the company's organization. A written definition of the management group's composition, tasks and the member's respective areas of responsibility may clarify the company structure.

Compensation Systems

Persons working for the company may be remunerated and bound to the company by means of different compensation systems. The purpose of such systems is to affect the activities of the persons concerned so that the company achieves its goals. According to its own principles the company can decide whether to apply or not to apply compensation systems, what kind of systems it applies and the persons to whom the systems apply. In addition to basic salary such systems may include inter alia incentive schemes related to the company's financial results, pension schemes and share-related compensation systems.

Internal Control and Risk Management

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

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

The board of directors and the managing director are responsible for ensuring that the company operates in compliance with the law and with the articles of association in the company's business. For that purpose the board of directors may for example determine the principles of internal control and monitor the compliance with those principles.

The distribution of tasks in small companies may result in so called risky task combinations where only a few persons take care of financial administration. Such risks may be reduced by means of monitoring by the board of directors and by means of reporting systems. Furthermore, such systems may facilitate the board of directors' supervisory tasks.

The organization of the company's internal control and how it operates depend inter alia on the character and the scope of company's business, on its geographical scope, on the number of employees and on other similar factors.

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

Risk management is one aspect of the company's control system. The purpose of risk management is to ensure that risks affecting the company's business are recognized and monitored. Such risks may concern for example decision making, the company's products, financing, competition, staff, environment related questions, contracts and liabilities. Risk management requires definition of risk management principles. Through comprehensive risk management the company may achieve its desired total risk level, in relation to the company's risk taking capacity so that the continuity of business is not jeopardised.

Audit

Auditors play an important role in the company because they act as the supervisory organ appointed by the shareholders. Auditors provide shareholders with an independent written report on how the company's accounts, financial statement and administration have been managed. Control of the company's administration constitutes control of compliance with the law, but not control of appropriate business conduct. That means that auditors do not take any position on business decisions.

How is the auditors' independent position secured? Are shareholders sufficiently well informed of auditor candidates before the general meeting?

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

Election of auditors is one of the most important decisions at the general meeting. Shareholders' decision making can be facilitated through providing information concerning the auditor candidates in good time before the general meeting.

The Articles of Association

The articles of association contain provisions on the most essential matters of the company's business activities. The articles of association concern all shareholders, the company's management, other company representatives and the auditors. The articles of association must fulfil the minimum criteria established in the Companies Act.

Do the articles of association adequately reflect the company's business activities and the shareholders' needs? Are the articles of association sufficiently flexible in relation to the size of the company, and do they contain provisions for regulating the most important questions in respect of the shareholders' rights?

The articles of association determine the mode of operation of the corporate organs. The articles of association can be rather narrow in scope, but from the shareholders' point of view it may be important to include in the articles also provisions on for example the election of the directors and of the auditors, on the rights of

different share categories and on distribution of profits. From investors' point of view and for the representation of the company it is important to define the company's line of business in sufficient detail.

For the purpose of controlling ownership the articles of association may contain so called redemption and approval clauses.

Flexible articles of association enable the company to grow without having to amend the articles. Amending them requires a qualified majority of not less than 2/3 of the votes given at the general meeting and of the shares represented at that meeting.

Shareholders Agreements

A shareholders' agreement is an agreement concluded by the shareholders concerning the administration of the company and the conduct of its business. Parties to that agreement may be either some or all shareholders. A shareholders' agreement may cover subjects that are not mandatory by virtue of the Companies Act, or are not in conflict with the articles of association.

Could a shareholders' agreement improve predictability of decision making in the company? Do the articles of association contain provisions that could be better included in a shareholders' agreement?

The shareholders' agreement is binding for its parties. Concluding such an agreement could be more appropriate and convenient than regulating a question in the articles of association. It could be more difficult to amend those articles than to amend the shareholders' agreement. Compliance with the shareholders' agreement could be ensured for example by including provisions for liquidated damages. The shareholders' agreement is often confidential.

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

A shareholders' agreement could be useful for example in the following cases:

- protecting minority shareholders,
- in a company where several shareholders hold equal numbers of shares,
- in a company financed by investors,
- in change-of-generations.

A shareholders' agreement could contain provisions on for example the purpose and objectives of the company' business, on seats on the board of directors and on the distribution of dividends. The agreement could also contain clauses on voting, first refusal clauses, redemption and approval clauses.

Redemption and Approval Clauses

The assignment of the company's shares to outside parties can be limited by means of redemption clauses. They can serve the purpose of granting shareholders, the company itself, or other persons, the opportunity to redeem assigned shares so that other parties cannot interfere. The articles of association may contain a redemption clause. That clause shall establish the persons who are entitled to redemption and how the order of priority between them is regulated.

Is there a need to restrict free trade with the company's shares, or to restrict the assignment of shares to non-shareholders? Does the redemption clause include sales, as well as donations, inheritances and distribution of matrimonial assets, or does the company wish to exclude certain kinds of acquisition from the scope of the redemption clause? Does the redemption clause serve the shareholders' present needs?

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

For the purpose of restricting the number of shareholders the articles of association may contain an approval clause to the effect that an assignment of shares is always subject to approval by the company. The articles of association can contain provisions for determining whether such approval is granted by the company's board of directors or the general meeting. If the articles of association contain both redemption and approval clauses, their internal priority order must be regulated.

Communication and Information

Good corporate governance requires reliable and sufficient communication and information by the company. On the basis of such information the shareholders are in a position to evaluate the company's business and to make decisions in respect of their holdings.

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

A clear presentation of matters concerning the company's corporate governance system enables the shareholders to form a comprehensive picture

of the company's operations. The company's corporate governance system can be presented in the annual report, or in some other manner. A good annual report is instructive, individual subjects are clearly defined and can be easily found. Publication of financial key figures may increase shareholders' confidence in the company.

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

Shareholders get information about the members of the board of directors and of the managing director, if those persons' personal data are published either in the annual report or in some other manner. Such data may for example include the following:

- name
- year of birth
- education and training
- main occupation
- essential working experience
- date of election to the board of directors
- most important simultaneous positions of trust
- holdings of the company's shares
- holdings and rights based on a share-related compensation system of the company.

On the basis of information concerning the members of the board of directors shareholders are able to evaluate the board members' competence for their job and their relations with the company.

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

On the basis of its own needs and requirements the company can decide how and to what extent it will inform its other interest groups about its business. The use of Internet as one

communication channel may increase awareness of the company and may improve information to its interest groups. It is easier to update information in electronic form than paper print bulletins; thus interest groups can get the latest news about the company.

Change-of-generation in Family Enterprises

Change-of-generation in family enterprises has important consequences for the administration of a company. A change-of-generation takes time and must be carefully planned. It is a complicated process. Transmission of experience and know-how to the follower must be prepared. Matters related to financial, family, inheritance and tax law must be taken into account.

Have preparations been made in respect of a possible future change-of-generation? Are those of the next generation aware of plans and decisions made in view of the change-of-generation? Has the company considered how and on what terms family members shall be involved in the company's business?

In view of a change-of-generation, and bearing in mind the size of the company, owners of family enterprises do wisely in creating a strong management team with a clear distribution of tasks and responsibilities. The chairperson of the board of directors may be the person most suitable for co-ordinating the planning and the implementation of the change-of-generation procedure. Owners of family enterprises, together with the next generation, do wisely in making plans and essential decisions in advance for the change-of-generation. In bigger family enterprises it may be appropriate to establish clear rules in respect of the principles for involving family members in the company.



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