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Sectors

## Corporate Governance

### Six Steps

IFC's corporate governance methodology involves six steps. This process first introduces the client to IFC's approach to corporate governance. The investment staff then reviews the client's governance practices and, where necessary, IFC develops a corporate governance improvement program with the client.

Matrices, checklists, and other tools used in this process are tailored for each of the four paradigms (investee company model). The tools are available online: Corporate governance tools.

#### Step 1: First Impressions

- Form an initial view on whether corporate governance poses a special risk or a good opportunity for IFC value-added.
- Select the governance paradigm (or combination of paradigms) to be applied to the company.
- Identify, if possible, specific issues that are likely to be priorities and whether there will be need for further resources from the Corporate Governance Unit.

At the earliest practical stage in the project cycle, the IFC investment staff should articulate their first impressions concerning the client's corporate governance. This will allow the selection of the appropriate paradigm to use with the client.

#### Step 2: Client Self-Assessment

- Begin the dialogue with the client and introduce IFC's corporate governance methodology.
- Send the client the appropriate progression matrix and the explanatory note "Why Corporate Governance?"
- Enable clients to assess their own governance against the progression matrix.

Before IFC conducts a thorough corporate governance review of the company, the client should carry out its own assessment. This self-assessment not only encourages the client to "buy-in" to the corporate governance dialogue, but can also act as the first step in IFC's own review.

#### Step 3: Corporate Governance Review

- Send the information request list to the client, at least three weeks in advance of the on-site appraisal, so that all the necessary background information can be acquired by the appraisal team prior to the review of the company's governance. The information request list (and the delivery of responses from the client) should be coordinated with other parts of the investment team's legal and financial information gathering.
- Implement an on-site review of the governance of the company, assessing which approximate "level" is achieved in the five key areas of governance outlined on the progression matrices and clarifying

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#### FEATURED PUBLICATIONS



**Banca Commerciale Romana: Deal Structure, Value Added and Outcomes**



**Case Studies (Eng., Port., and Esp.)**



**IFC and Corporate Governance (Eng., Port., and Esp.)**



**The Irresistible Case for Corporate Governance**



**Regional Corporate Governance Factsheets**

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any outstanding issues from the Information Request List.

- Decide whether the client needs to undertake a corporate governance improvement program. The basic purpose of the corporate governance review is to acquire understanding about the company, with a view to identifying risk and opportunity and, if necessary, developing an improvement program.

In most cases the IFC investment staff on the appraisal team carries out the corporate governance review. If corporate governance has already been identified as a particular priority (or where specialized knowledge of certain governance topics is required), specialists from the Corporate Governance Unit can carry out the review. Even in these cases, however, the primary IFC investment person should take an active role in the review. The review should take place as part of the investment appraisal.

#### **Step 4: Corporate Governance Improvement Program**

- Prepare an analysis of the company's governance, highlighting areas for improvement and making proposals to address governance weaknesses.
- Develop a corporate governance improvement program with the client that is specifically tailored to the needs of the company.
- Agree with the client on a timetable and methods for the implementation of this program.
- Identify areas where IFC or others can assist the company in its corporate governance improvement efforts even after the transaction has taken place.

If the corporate governance review identifies a need for an improvement program for the company, this program will be developed by IFC in cooperation with the owners and senior managers of the company. In developing a program, the IFC investment staff can draw upon IFC's various [corporate governance resources](#). In some cases, the program will be comprehensive, covering all five key areas of corporate governance. In other cases, the program will be more narrowly focused. For example, it will concentrate only on areas where risks or opportunities are identified, such as the board of directors or equitable treatment of shareholders.

#### **Step 5: Documentation and Implementation**

- Draft the operational documentation outlining the agreed improvement program, such as the Term Sheet, Loan Covenants or Shareholders Agreement.
- Decide upon the appropriate degree of legal enforceability of the program and what penalties, if any, are appropriate for the failure to implement the program.

Identify any need for continuing assistance to the client after the disbursement.

To ensure a common understanding of the corporate governance improvement program and to assign clear accountability for its effective implementation, both the program and the timetable for its implementation should be appropriately documented. There is wide flexibility in the operational documentation that can contribute to this goal, including term sheets, loan covenants, and shareholders agreements.

The degree of legal enforceability of the improvement program may also vary. A variety of client-specific factors will affect both the

operational documentation that is used and the enforceability of the program, including: the nature of the governance reforms; IFC's reputational risk; the alignment of incentives between IFC and the client; and the client's demonstrated commitment to improved governance.

There should be an appropriate timetable for implementing of the improvement program. Rarely will it be practical to require the company to carry out all the reforms prior to disbursement. In some cases, the client may continue to need assistance after disbursement, for example, drafting a corporate governance code or recruiting independent directors. This continuing assistance could come from either IFC or from one of the national corporate governance institutes that IFC is supporting through its participation in the Global Corporate Governance Forum.

#### Step 6: Supervision

- Use the *Supervision Checklist* to ensure the continuing adherence to the agreed corporate governance improvement program.
- Identify the need for further corporate governance assistance.

The IFC staff responsible for the subsequent supervision of an investment should become well acquainted with the client's corporate governance improvement program in order to monitor its implementation and identify need for further assistance.

This process is designed to be conducted as an integral part of the appraisal for new investments. However, the methodology is flexible so that it can be adapted to other circumstances, such as supervision of and assistance to existing portfolio companies.