

Corporate Governance: A Building Block for the Startups

The concept of Corporate Governance (CG) has gained pace recently especially in the developing economies. Reputed companies in these economies often give much importance and follow the standard protocols of CG. However, when it comes to startups, the concept of CG is often not paid much attention because of which startups often face problems in management and financing and undervalued acquisition. Corporate Governance can be a powerful tool for these startups facilitating their sustained growth thereby minimizing risk and failure.



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INTRODUCTION

There has been a spike in the startup failures owing to lack of Corporate Governance. The financial consequences to investors were enormous. As a result, angel investors and Environment, Social, and Governance (ESG) investors now closely scrutinize even the most promising startup company's governance practices. The result is that startup companies are now required to adopt and follow best CG practices. Corporate governance is about conducting business properly by employing appropriate strategy and processes including focus on building trust, accountability, and disclosures. There is a widespread clamor that corporate governance has to be strengthened in startup companies in light of recent stories

about corporate misgovernance and a lack of due diligence making headlines in respect of new ventures. It is impossible for founders to outsource governance, a crucial topic that needs at least as much attention as assessing the scale and pace of expansion of the company.

WHAT IS A STARTUP?

A startup company is a new business that is potentially fast growing and aims to fulfil an existing need in the marketplace by developing and offering a new and unique product, process, or service. Most countries of the world consider the development and implementation of innovative technologies, products and services as an essential catalyst for spurring economic growth. Therefore, it is essential to create and market new goods and technologies if the nation is to become a leader in innovation and, consequently achieve competitive superiority young businesses have taken over billions of lives, solving problems that previously appeared to be unsolvable. A startup is a novel concept that has tremendous potential. A startup is often a business that aspires to introduce a brand-new, ground-breaking service, item, or method to the market. The entrepreneur who initiates an idea and converts the same into a business proposition is typically the founder. Often, the founder seeks angel or venture investment when things are still modest. Many different channels can be used by startups to raise money and gain traction.

CHARACTERISTICS OF STARTUPS

- **Lack of any background:** Young companies have very limited background information.
- **Little or no revenues, mostly operating losses:** Startups at an early age generally run into losses as their operating cost is high. Revenues for these companies are nearly negligible especially for idea companies hence running into significant operating losses.
- **Survival rate is very low:** The complex environment often makes the path for survival treacherous for these companies so many of the startups do not survive or sustain in the market.
- **Multiple claimants on equity:** Since startups are in need of funds, they may need capital frequently and hence the claim of equity shareholders get progressively diluted as new equity investors join in.
- **Illiquid investments:** The investments in startups are generally held privately this makes it difficult to liquidate the investment.

CORPORATE GOVERNANCE

An organization's corporate governance is its heart, and it must be upheld as it conducts its everyday business. A system of holding managers accountable to stakeholders for the successful administration of firms is called corporate governance. Corporate governance concerns itself with the morals, ethics, values, conduct and behavior of the organization and its management. The underlying principles of corporate governance revolve around three basic interrelated dimensions. These are:

1. Integrity and Fairness
2. Transparency and Disclosures
3. Accountability and Responsibility.

Corporate governance deals with laws, procedures, practices and implicit rules that determine the practice of the organization to take managerial decisions vis-à-vis its claimants i.e., stakeholders.

STARTUP GOVERNANCE: AN ESSENTIAL BUILDING BLOCK FOR SUSTAINABLE SUCCESS

Corporate Governance is much more challenging in a startup than an established corporation however many entrepreneurs fail to realize this. CG is a framework which helps them to grow while also balancing the needs of stakeholders including shareholders, employees, customers and society at large. A strong CG architecture is built upon high standards of integrity, accountability, transparency, fairness, and responsibility and this in turn leads to increased trust of stakeholders which is essential for its survival. Hence, CG shouldn't be viewed as an obstruction in the path of decision making but as a means to foster logical decision making and maintaining high standards for ethical and legally compliant processes.

Corporate Governance is not a conventional buzz word in the startup circles. Startup company boards should implement universal best practices for corporate governance. These can include:

- Creating a diverse (based on gender or race) board of directors
- Selecting directors with a rich background of different types of skills & expertise
- Transparency and regular communications between the C-Suite & BOD, & stakeholders
- Board meeting practices, take good minutes, encourage participation

Corporate governance actually implies: accountability, transparency, probity and focus on sustainable success. Accountability refers to the board's overall responsibility on the nature and extent of risks taken by the company to achieve its strategic objectives. Startups that lack formal board structures and well-established good governance procedures run into the danger of failing. The full disclosure of any potential conflicts of interest between the board and the corporation is referred to as transparency. Probity and ethics should be the driving force that the board of directors should follow when it comes to providing a strategic direction. Finally, the big picture of corporate governance is provided by sustainable growth of an organization.

WHY IT IS IMPORTANT FOR THE STARTUPS TO INCREASINGLY PRIORITIZE CORPORATE GOVERNANCE

It is imperative for companies to inculcate CG at an early stage to manage the growth since growth frequently necessitates additional capital and the need to attract new investors who may want to see strong CG processes and procedures in place; organisational practises need to be consistent with investor expectations; and growth can happen quickly, so it's important to make sure the right controls and processes are in place before it happens.

The company's innovative nature may require them to quickly modify and adjust their business models and doing so while keeping investor expectations in line could be quite difficult.

Creating boards that are either uninvolved or too involved in decision making can be avoided by establishing corporate governance structures early on. CG enhances transparency and contributes to the development of trust among investors and other stakeholders.

STAGE WISE APPROACH TO ADOPTING CORPORATE GOVERNANCE PRACTICES FOR START-UPS

The scope and size of the start-up should be considered when determining the architecture for CG, which is dynamic and ever-changing. A start-up may require support in the early stages with incorporation and selection of the most effective company structure. As the start-up gains traction, builds a team and starts earning revenue, GST registration and compliance with labor laws, SEBI, and other laws becomes an indispensable part. Choosing the right financial instrument, negotiation and valuations fundraising has to be seamless. Growing start-ups should think about adopting anti-money laundering, anti-bribery, and anti-employee harassment policies. The importance of corporate governance may not be apparent on a day-to-day basis but missing a filing deadline or registration can have adverse long-term consequences. Corporate governance is a powerful tool to reduce the challenges faced by firms and can facilitate growth.

BEST PRACTICES FOR BUILDING GOVERNANCE STRUCTURES AND PROCESSES IN STARTUPS

A successful business requires good governance and so does startups to prosper and grow. However, CG is often misunderstood as a practice reserved for large multinationals and publicly listed firms. It must be noted that as the startups evolve so should the CG practices. Being influenced not just by the size but also the expectations of various stakeholders, CG requirements evolve as a startup grows. There need to be a balance between the different stakeholders, where especially the interaction between founders- entrepreneurs-shareholders-managers on one side and the external shareholder on the other is a tricky one. The key values and interests revolving around creativity, freedom, growth should be taken into account and above all respected by the governance structure. Another governance dimension concerns the necessity to maintain a creative, entrepreneurial free spirit and congenial atmosphere in the company while

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on the other hand a necessity to manage and control the company through instruments such as budgets, reports, procedures.

One of the main issues unique to startup companies is that there appears to be a discrepancy amongst investors about the importance of governance processes and procedures. Some investors are highly passionate about making sure sound governance principles are in place, while others—both newer and more seasoned investors—appear to either take a “check the box” approach to governance or place less importance on board structure and governance concepts and practices (and therefore do not ask for them).

Companies in their early stage, especially one with innovation and exponential growth potential should proactively invest in CG by ensuring presence of quality and strong board members. To ensure a strong set of board members the role of each member must primarily be precisely described, and it must be ensured that their actions are aligned with the overall mission and vision of the organization as well as the investors. Hence, the board members should neither be under involved by merely fulfilling an obligation to have a board seat or over involved in business operations as both can be detrimental. Board meetings must be held regularly to promote active participation of the board members. The role of board must evolve as the organization grows and innovates, but strong, well-functioning board adds add value at every stage of a company's growth and development. It must be appreciated that early-stage company's board are different from mature company's board. In more mature companies, the board traditionally has an oversight role with a strong focus on strategy, financials and internal controls. The role of board may vary depending on the stage at which the company is.

There is need for having the right kind of experience on the board in case of startups. Board members should bring skills and experiences that support and complement the management team as the entrepreneurs might lack in skills like business networking, business development, predicting

the expectations of stakeholders. Hence, the board members must bring in the skills the entrepreneur lacks. Board members should have a passion for impact and be aligned with company values for being instrumental in ensuring the long-term success of the company. An early-stage company's corporate governance structures must be suitable for their intended purpose at various stages of their life cycle. The structures should change as the company does to fit and be in sync with size, complexity, and risk profile of the business. As a startup company matures, its board gradually formalizes functions previously executed informally. Example of this includes the formation of board committees to carry out specific tasks to support board functions and decisions.

CONCLUSION

The premise of a healthy balance between the interests of different stakeholders, including the promoters, shareholders, employees, and customers, is at the heart of corporate governance. Its four pillars are accountability, integrity, transparency, and responsibility. A business should constantly work to increase its accountability and transparency to its stakeholders. One can accomplish this and increase shareholder wealth with the help of a well-designed governance strategy that is properly implemented throughout the business. Building an effective corporate governance strategy that matches the startup's development stage of growth is a common difficulty for startups. When creating CG game plan, startups frequently take a “short term-long term” approach. However, we think that taking a more evolutionary approach would be more productive and efficient. Governance rarely receives the attention it deserves in the frequently frantic setting of starting a business (although this appears to be changing). Implementing effective corporate governance is not a simple undertaking given the limited resources (in time, experience, and skill) of a startup however, this does not make it any less vital.

Governance will be the key in different phases of the life cycle of startups.

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