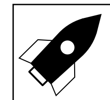

CORPORATE GOVERNANCE IN STARTUPS BALANCING INNOVATION AND SUSTAINABILITY

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In an increasingly complex and globalised business world, corporate governance can guide companies to sustainable success if well implemented. This article will explore how startups can build and maintain a governance model that balances sustainable growth and business agility, attaining success in today's market.

INTRODUCTION

Corporate governance defined in the growth phase of a startup can drastically influence its future, acting as a catalyst for its success or failure. This article explores governance practices and perspectives of investors and CEOs to build models that foster sustainable growth and business agility in startups. Furthermore, it analyses the balance between the expectations of investors and CEOs, who, although united by the desire to succeed, have divergent visions and goals, and thus maintain an agency relationship (Fama, 1980; Fama & Jensen, 1983).

While united by their desire for business success, these groups often have divergent visions and objectives. Investors seek security in their investments, aspiring to clarity and predictability in company strategies and direction, and prefer transparent and accountable

corporate governance models that foster sustainable growth. On the other hand, CEOs face the challenge of navigating a complex operating environment, balancing the demands of investors with the need to maintain flexibility, foster innovation and, at times, make decisions in an agile manner.

In an increasingly complex and globalised business world, corporate governance emerges as the beacon that can guide companies to sustainable success if implemented in the right way. Good governance practices are essential in a world where transparency, accountability and sustainability play a critical role.

This article, through a discussion of different governance techniques and perspectives of investors and CEOs, will seek to shed light on how Startups can build and maintain a governance model that promotes synergy between sustainable growth and business agility, which is essential for the success of any Startup in today's market.

Corporate governance plays a key role in strengthening the ability of companies to access global finance, providing credibility and ensuring fair and responsible management of capital.

WHAT IS CORPORATE GOVERNANCE?

Definitions vary widely across regions, but corporate governance can be summarised as the relationship between organisations, their management teams, their board of directors, their shareholders and their stakeholders. Or, more specifically, it is the process by which organisations assure their investors of the presence of a proper and supervised management team and thus the appropriate, responsible and cost-effective allocation of their resources (Gregory, H. J., & Simms, M. E., 1999). Ultimately, it is crucial because it sets the framework for all business activities from strategy to risk management and cybersecurity (Diligent Corporation, n.d.).

Although there are different models of corporate governance, they all follow the same principles: ensuring fair and considerate dealings with stakeholders surrounding the organisation, adding transparency on financial performance, potential conflicts of interest and external risk management, overseeing the management team acting in the interest of the company and its investors, and communicating issues of importance to the organisation's shareholders (OECD, 2023).

In startups, effective corporate governance is crucial to increase trust between investors and financial institutions, improve decision-making and provide the organisation with a solid structure, mitigating risks and conflicts of interest. Good corporate governance clarifies the rights and obligations of founders, shareholders and the board of directors, promoting structured and consistent management practices, essential for sustained growth and success (ASOMIF Ecuador, 2021).

IMPORTANCE OF CORPORATE GOVERNANCE

Corporate governance plays a key role in strengthening the ability of companies to access global finance, providing credibility and ensuring fair and responsible management of capital. It also fosters transparency and accountability in strategic decisions by providing an external check and balance that monitors the performance and actions of management. At the same time, it contributes to improving organisational resilience by establishing a second line of control for social, economic and environmental risks, enabling the company to maintain a responsible relationship with institutions and comply with local regulations (OECD, 2023).

In the startup context, corporate governance offers a series of benefits specific to its growth context (ASOMIF Ecuador, 2021):

- **Attracting capital and investor confidence**
  Good corporate governance practices are a key differentiator for startups to access external funding. A robust governance system reflects effective and accountable management, which increases investor confidence by showing that capital will be managed efficiently and transparently. This makes it easier to raise the resources needed to drive the company's growth.

- **Agile strategic decision-making**
  Strong corporate governance in startups not only adds value through diverse and expert perspectives but also drives agile and well-informed decisions, which are essential in a fast-growing environment. A balanced board facilitates continuous adaptation to market changes, ensuring that the startup maintains flexibility and strategic focus, which is crucial to its long-term success.

- **Alignment between founders, managers and investors**
  In startups, where founders play a central role, good corporate governance is essential to establish policies that align the interests of management, investors and other stakeholders. Based on agency theory (Jensen and Meckling, 1976), effective governance reduces conflicts of interest between actors with divergent objectives, improving cohesion, efficiency in decision-making and return on investment.

- **Risk mitigation in an uncertain environment**
  Startups, especially in their early stages of growth, are exposed to a range of financial, operational and strategic risks. A sound corporate governance framework allows them to better anticipate and manage these risks, helping to protect reputation and ensure regulatory compliance. This not only reinforces stability and transparency but is also crucial to sustaining success as the startup scales.

Effective governance reduces conflicts of interest between actors with divergent objectives, improving cohesion, efficiency in decision-making and return on investment.

Implementing sound governance practices offers long-term benefits, such as preparing the company for a possible IPO, improving sustainability and increasing expectations for future growth (Harvard CorpGov, 2021). It also minimises agency costs by reducing conflicts among stakeholders. Effective board oversight ensures that critical decisions are always made in the best interests of the company.

CHALLENGES IN IMPLEMENTING CORPORATE GOVERNANCE

Implementing good corporate governance in a startup entails significant challenges, mainly due to its resource constraints, size and urgent growth needs. Here are the key challenges:

- **We don't have time for those things**
  Time is a tremendously limited resource for startups (Al-Alawi et al., 2023), which, unsurprisingly, tend to prioritise investment in product design and lead generation over the implementation of more formal governance structures. However, the most common stressors associated with business failure in these firms are directly linked to areas where control mechanisms can provide crucial support, such as operational management, working capital control, understanding the competitive environment and preventing over-optimism in growth expectations.

  While it is true that the focus of time varies greatly depending on the stage of evolution of the

Startup, both in the pure ideation and development phase and in the scalability phases, a correct governance model can fulfil critical organisational functions for the sustainability of the business, whether in the search for investors, identification of possible collaborations or definition of the pool of talent needed to run the project.

We need to focus on innovating! This structure will make us slow

Once the need to implement corporate governance mechanisms is understood, there is a logical fear that they will slow down those behaviours that are understood to be a priority for business success, such as innovation, commercialisation of ideas, continuous product improvement, etc. (Chokheli, 2023).

while larger boards can slow down decision-making, good governance practices, such as innovation-specific committees, can expand the pool of knowledge and perspectives, thus improving the innovation capacity of the startup (Matoug et al., 2024; Baum et al., 2022).

Several studies have shown that the diversity of governance teams, both at the functional (knowledge), occupational (professional) and relational (presence in governance mechanisms of other organisations) levels, positively fosters the innovative capacity of the organisation (Kim & Kim, 2015).

Who can be part of these structures

When small and medium-sized companies create governance structures, they tend to move towards less formal structures than a management committee, tending towards advisory boards (Ding et al., 2013; Schiehll et al., 2018) and family boards (Arzubiaga et al., 2018; Gnan et al., 2015).

However, the inclusion of professional directors can compensate for the lack of experience of the founders, bringing crucial human and social value (Barroso-Castro et al., 2022). This balanced approach can help the startup make more informed and responsible decisions. The inclusion of both internal and external advisors is vital. External advisors can mitigate self-interested behaviour and improve control over the management team.

How should I compensate them

The remuneration of board members is critical to fostering the attraction of the best possible talent as indicated by managerial talent theory (Meyers, M. C. et al. 2014), as well as to minimise divergences between shareholders and the management team (Elnahass et al. 2022). Some authors have shown that share-based payment can affect risk aversion (Martinez-Moran et al., 2020) and thus the innovative capacity of the startup in its initial phase (Hoskisson et al., 2002).

Implementing effective corporate governance in a startup involves balancing innovation with structures that support growth and mitigate risks. Good governance practices offer advantages by incorporating diverse perspectives and improving operational and financial management, strengthening the internal structure and preparing the startup to face business challenges in a sustainable manner.

CORPORATE GOVERNANCE MODELS FOR STARTUPS: CHOOSING THE RIGHT PATH TO GROWTH

Corporate governance is critical to ensure the sustainability and growth of any organisation, especially for startups, which face unique challenges as they evolve. Governance models can be grouped into two broad approaches according to their orientation: the shareholder-centric model and the stakeholder-centric model. Each of these approaches offers advantages and disadvantages that startups should consider when designing their governance structure.

On the one hand, the **shareholder-oriented model** focuses on maximising returns for investors, who are considered the true owners of the company. This approach seeks to increase wealth and financial performance by putting investors at the centre of strategic decisions. On the other hand, the **stakeholder-oriented model** expands the horizon of governance by including all stakeholders related to the organisation, such as employees, customers, suppliers and society at large. This broader approach recognises that financial success is not the only objective, but that the social and ethical impacts of decisions must also be considered (Neagoe, A. L., 2022).

However, in choosing an appropriate governance model, startups need to take into account their particular context. **There are four main models that stand out in this type of start-up, each with its own advantages and disadvantages:**

1 Founder at the centre

This model places the founder as the central figure in strategic decision-making. The main advantage is agility and clarity of vision, as decisions directly reflect the founder's personal objectives. However, the risk lies in the lack of oversight, which can lead to biased decisions or conflicts of interest if the founder prioritises his or her own interests over those of the company (Fan, 2020; Board Foundation, 2023).

2 Professional CEO

In this case, day-to-day management rests with an external CEO, with extensive experience and sector-specific knowledge. This can provide an objective and less biased view, which is crucial for sustainable growth. Still, it can create tensions between the CEO and the founder, as well as representing a significant investment for the company (Board Foundation, 2023; Harvard Business Review, 2021).

3 Balanced board

This model combines the founder's vision with the input of independent directors. Diversity of opinion improves the quality of decisions by integrating broader and more informed views. However, it can slow down processes due to the need to reach consensus, as well as increase the risk of conflict among stakeholders (Harvard Business Review, 2021; Pitchbook, 2021).

4 Active investors

Here, investors play a key role in governance, providing not only capital but also expertise and valuable contacts. However, this entails a loss of control on the part of the founder, who must align with the interests of investors and may be limited in his or her decision-making capacity (Pitchbook, 2021; Board Foundation, 2023).

The selection of the most appropriate model

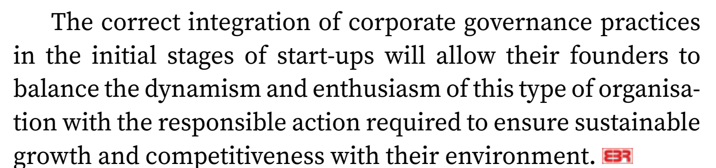
depends on the specific momentum of the start-up. Founders should carefully evaluate the advantages and disadvantages of each option and adapt their governance structure to ensure solid and sustainable long-term growth. In addition, when including third parties, it is crucial to select the right partners, both in terms of experience and cultural affinity. Thus, governance becomes a key tool for startups not only to survive but to thrive in highly competitive markets.

CONCLUSIONS AND RECOMMENDATIONS

The implementation of governance mechanisms in Startups is shown to be a crucial process for the correct development and evolution of the organisation, **however, its design and implementation must be strategically opportune from several perspectives:**

- **From a temporal point of view**, it is essential to integrate governance mechanisms as soon as feasible. Even if the initial focus is on product development and commercialisation, **governance should be on the radar from the beginning.** Considering governance as a long-term investment will help to avoid management problems as the company scales up.
- To **maintain the organisation's momentum**, the Founder/CEO must **be alert to those processes where more formal governance models may slow down** decision-making or stifle innovation. To avoid this, it is key to **encourage diversity** on the board and in governance mechanisms, making sure to include people with different functional, occupational and relational perspectives.

- The Founder/CEO should implement a governance structure with an **independent advisory capacity.** In addition, it is advisable to establish internal and external audits to mitigate risks and improve transparency, as well as **specialised committees to oversee critical areas of the business through clear reporting systems.** These actions should be implemented in an orderly and structured manner as the company grows.
- **Board compensation should be aligned with organisational strategy.** In the early stages, share-based payment may stifle innovation by increasing risk aversion, but in mature stages, it will encourage risk management and strategic sustainability. It is crucial to **consider which method will best incentivise the long-term growth** and stability of the organisation.
- The Founder/CEO should **carefully consider the use of equity compensation**, as it may not be the most appropriate model at all stages of development. If the company is in an ideation or aggressive growth phase, this method may increase the risk aversion of the management team and limit the ability to innovate. In these cases, it would be more appropriate to opt for compensation methods that maintain the focus on innovation and growth, without reducing risk tolerance.
- The Founder/CEO should **seek an appropriate balance between internal and external advisors get the best from both perspectives.** The inclusion of external advisors can bring fresh and challenging visions that introduce best practices from the market, however, it is equally important to have internal advisors who understand the day-to-day reality of the organisation, which will allow for a proper balance in decision making and better alignment with business objectives.



The correct integration of corporate governance practices in the initial stages of start-ups will allow their founders to balance the dynamism and enthusiasm of this type of organisation with the responsible action required to ensure sustainable growth and competitiveness with their environment.

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