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Corporate Governance in the Start-Up: A Significant but Missing Essence of Business

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ABSTRACT

The Start-ups in their initial stage find it a challenge to have a corporate governance practice in place especially when they are struggling to break even. However, as they grow the need for such compliances now become apparent and often due to fast pace growth there are certain lapses in the corporate governance compliances within the organisation. The author in the present research paper have analysed and identified the need for start-ups to comply with corporate governance from very inception. The recent case studies of corporate governance lapses at Zomato and Bharat pe has been highlighted. Further, effort has been made to identify challenges faced by start-ups in India which indirectly make founders or directors reluctant to comply with corporate governance norms in some cases. Towards, the end several measures have been recommended on how start-ups can make compliance with corporate governance norms a part of the very culture of the organization.

Keywords- Corporate Governance, Start-up, Bharat Pe.

I. INTRODUCTION

“Shareholder value gets lost when things are done illegally, when corporate governance is not adhered to, when cohesive action is not taken”~ Cyrus Pallonji Mistry

At the first instance it makes sense to founders of start-ups to not put legal and accounting responsibility to be a high priority for their bootstrapped start-up as these compliances require certain investment and is also time consuming. However, with the Tsunami of new age start-ups being launched in India in last five years- they are now realising importance of observing corporate governance norms from very inception as things get heat up few years down the line for these start-ups when various investor’s requests need to be suitably accommodated, supplier defaults on contracts, and ESOPs needs to be negotiated.

As these start-ups grow their team as well as business- they find themselves to be now required be in compliance with GST laws, Labour laws, and several other compliances. For many start-ups not observing corporate governance norms presents a hurdle in few years down the line when they have to raise funds from some angel investors but the process is delayed due to not

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well-defined leadership structure, not having policies drafted for various internal functioning of the organization including remuneration and promotion of employees and all this ultimately hamper their growth.

For many founders of start-ups at the first instance the need for corporate governance may not be apparent on day-to-day activities of their business, however, it is when they either miss a filing deadline² or certain registrations or disclosures for their businesses that they later realise that the expenses now being incurred due to penalties and rectification of errors far exceed the expenses like hiring professional or investing time in framing policies which if they would have incurred in the very beginning could save a lot of trouble and money for them now.

II. IMPORTANCE OF CORPORATE GOVERNANCE FOR START-UPS

Corporate Governance is not going to impact revenue- why bother investing resources when the business itself is struggling?

The Indian Government in recent years to promote start-up culture in India has come with various policies to promote ease of doing business for start-ups by relieving them from the duty of stringent disclosures requirements unlike listed companies.

1. Identification of discrepancies

The start-ups must not take the above liberty provided to them to be an opportunity for mismanagement as conducting regular audits can highlight discrepancies and gaps which can be fixed. However, adverse audit reports if generated by a start-up is a path towards self-destruction in future.

2. Enhanced level of investment readiness

Start-ups which stresses on having a culture of compliance find their business to have a greater interests from potential investors at most of the times and which put them far ahead their competitors.

3. Escaping the possibility of legal action by government authorities

The companies can be strike off by registrar of companies if found to be not in compliance with certain rules including not filing annual documents or providing various other documents.

4. Crucial during possible M&A in future

Strategic Merger and Acquisitions can take an organizations ahead by many years and unlock

² Shradha Mani, *Corporate Governance for Start-ups- Premature or Paramount?*, Businessworld.in, Accessed on 10th April 2022, at <https://www.businessworld.in/article/Corporate-Governance-For-Start-ups-Premature-Or-Paramount-/07-04-2019-168837/>

a wider market and provide window of opportunities to start-ups. Start-ups complying with corporate governance norms is well-received by various stakeholders³ during M&A.

III. CASE STUDIES

In the recent times, independence of Start-up directors have come to be a major point of discussion in several cases. It is the duty of the Board of directors to comply with corporate governance norms and develop strategy aimed at promoting shareholder's value. However, in private un-listed entity or in any start-up there is no one to ensure such practices being actually observed.

In fact, we often see directors getting compensation from investors or having side-contracts of commercial nature that would refer to the engagement as "advisory" ?

IV. BHARAT PE CONTROVERSY

The recent Bharat pe controversy has again brought the issue of need for corporate governance for start-ups in lime light. Ashneer Grover, co-founder of Bharat Pe resigned from the company after services of his wife who was also head of controls at Bharat pe was terminated. Later, the company is now conducting a governance review and it is alleged that company's funds were misappropriated and several corporate governance issues under Ashneer Grover are now being identified by the Board.

V. ZOMATO CONTROVERSY

Gaurav Gupta who was designated as one of the co-founders in 2019 and also Head of supply in 2021 resigned from the company and yet, The Zomato which is now a public-listed company didn't update the exchange as according to the company he was not designated as key managerial personnel.

VI. CHALLENGES FACED BY START-UPS THROUGH THEIR JOURNEY

1. Inception

Often Start-ups in India have a difficult time when they begin their operation including scarce resources, continuous losses, and it therefore becomes premature for them to focus on corporate governance.⁴ This is one of the most common reason for start-ups not stringently complying

³ Sakshi Shairwal, Corporate Governance and its importance in start-ups, Sakshar Law Associates, Accessed on 10th April 2022, at <https://www.lexology.com/library/detail.aspx?g=b93536ed-efcc-4ac0-9af1-e9934f8f1b86>

⁴ Abdulwahid Hashed, (2020) *Impact of corporate governance mechanisms on financial reporting quality: a study of Indian GAAP and Indian Accounting Standards*. Problems and Perspectives in Management 18:4, pages 1-13.

with regulatory provisions.

2. Fear of “check and balances” hampering with the growth

It is often common mis-conception that for early age start-ups just starting their operations and which are not even breaking even having “check and balances” or observing corporate governance can slow down the growth or innovation.

3. Lack of Trust

The Start-ups often grow at a higher rate compared to a mature company merely because the size of any start-up initially is small and there is an opportunity to expand the business. Start-up often find it difficult to appoint an independent Director who is completely unknown to founders or any of the directors of the company⁵ and ironically the law requires these independent directors to be falling into that category which start-ups neglect.

VII. CONCLUSION AND RECOMMENDATIONS

The regulatory compliances which were eased out in India to drive growth for start-up- appears to have now having its own chilling effects. The number of start-ups in India is only poised to grow in number and having a fair share of founders come from a non-management background, it is important for corporate governance to adapt to the new needs of these firms. Hence, some of the ways in which Start-ups can ensure effective compliance with corporate governance norms especially during early stages of growth are-

- 1) To address the dilemma of whether or not to invest corporate governance when the business of start-ups itself is struggling in the beginning, the author would like for all such start-ups facing this challenge to have a “check the box” approach to meet all mandatory legal, financial and accounting requirements. Start-ups can initially rely on professionals to help a start-up in compliances.
- 2) The Start-ups must have a book-keeping professional in their team and to whom they can pay in equity if the resources are scarce, and it allows start-up founders to focus on core competency, and saves their time which they would have spent juggling between tax registrations and corporate filings.
- 3) The founders of Start-ups or Board of directors must in the very beginning define and draw lines i.e. for example an investor board member must not be involved in operations of the start-up.

⁵ Robin, *Corporate Governance in India, Issues and Importance*, 6 International Journal of Research and Analytical Reviews 922, 924-927 (2019)

- 4) The Start-up must aim to have a board meeting every fortnight or monthly with either their employees, investors, co-founders to discuss the vision and oversee any breach in regulatory compliance or identify any mis-match or mis-use of company funds.

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