CORPORATE GOVERNANCE

What ESG, or the lack of it, has to do with governance lapses in startups

By Sudipto Dey Jul 28, 2023, 04:30 AM IST

Synopsis

Two reports have highlighted the need for alignment between startup founders, investors, and the board for any governance framework to be successful. Besides, they add, the framework has to evolve as the maturity level of the startup progresses.

Earlier this week, two key investors in ed-tech firm Byju's separately flagged off corporate-governance concerns while elaborating on the reasons for exiting the startup's board last month.

Prosus, one of the largest technology investors in the world and the largest non-promoter shareholder at Byju's, said that the ed-tech company's reporting and governance structures did not evolve sufficiently for a business of that scale. The other investor, **Peak XV Partners**, reportedly cited its inability to influence the management to improve its compliance and governance norms among the reasons for its director to resign from the board.

In June, the nominee directors of three investor groups — Prosus, Peak XV Partners, and **Chan Zuckerberg** Initiative — quit from Byju's board, following the resignation of the statutory auditor, citing inordinate delays in firming up the company's financial results. The ed-tech startup has been involved in disputes with lenders, and facing challenges in raising fresh capital.

Byju's is in the process of setting up an advisory board of independent members, which includes TV Mohandas Pai, former CFO of **Infosys**, and **Rajnish Kumar**, former chairman of State Bank of India.

While the travails of the country's biggest ed-tech brand has been hogging the headlines, there have been several reported instances of corporate misgovernance incidents in other startups, too. This largely coincided with the tightening of the private-capital flow into the Indian startup ecosystem as global financial market sentiments sobered down over the last one year or so.

As if taking a cue from adverse investor sentiments, and the implications on the country's image as the world's third-largest startup ecosystem, policymakers, industry associations, and key stakeholders in the startup community have come up with recommendations on how **ESG** norms can pave the way for inculcating compliance and best practices.

Two recent reports have highlighted the need for alignment between startup founders, investors, and the board for any governance framework to be successful. Besides, they add, there has to be room for the framework to evolve as the maturity level of the startup progresses.

Sage advice for new entrepreneurs

Two sets of recommendations — one from Startup20 Engagement Group, under the aegis of India's G20 presidency, and the other, **Startup Governance Playbook**, by the India Venture Capital Association (IVCA) — have advocated self-regulation as a means to improve corporate governance and compliance practices in Indian startups.

In the foreword to the *Playbook,* IVCA president **Rajat Tandon** points out, "Governance is not a one-size-fits-all concept. It evolves with the stage and the maturity of the startup, the nature and the composition of the board, and the external environment. Therefore, it becomes imperative that startups adhere to compliances, corporate governance, and a framework of protocols, irrespective of the scale."

Similar sentiments were echoed by G20 sherpa Amitabh Kant in the **report**, *Think tank Recommendations on Corporate Governance for Indian Startups*: "Indian startups must give priority to good governance and financial management since inception, and not consider these as an afterthought."

A shared responsibility

The recommended governance framework by Startup20 Engagement Group highlights the need for startups to manage ESG risks and opportunities. It categorises startups into three clusters, depending on their maturity level: Level 1 - inception to early stage; Level 2 - early stage to growth stage, and Level 3 – growth stage to IPO.

The report recommends that mature startups in the growth-to-IPO stage should tick all the boxes related to managing ESG risks and opportunities. These include board ESG oversight, ESG disclosure, tax practices, corporate culture, workforce and human rights, and climate change.

> **"The government must remain at an arm's length.... The founders [of startups] must act towards being self-regulating."**
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> *— Amitabh Kant, G20 sherpa*

This is akin to what a listed entity of certain size is supposed to do while meeting ESG-performance parameters under the Business Responsibility and Sustainability Reporting (BRSR) framework mandated by the capital markets regulator, Sebi.

For startups in the early stage to growth stage, the compliance requirements are less onerous, leaving the responsibility to the board to oversee ESG-related issues. The report does not recommend any ESG performance requirements for startups in the inception to early stage.

Interestingly, Kant does not envisage any role for government regulations in a governance framework for startups. "The government must remain at an arm's length.... The founders must act towards being self-regulating," he reportedly said while launching the report.

With ESG performance parameters being mentioned in discussions related to governance frameworks for startups, the spotlight will inevitably shift to the roles of founders, investors, and the board. Moreover, ESG considerations will implicitly play out in the way startups do business and run their operations. If start-ups do not get their 'G' right, their 'E' and 'S' are also likely to falter. That would make life difficult for founders, investors, and the board.