Implementation of Recommended Corporate Governance in Startup Companies

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Startup companies suffer from various failures which the classic corporate laws are not equipped to address: significant conflicts of interest throughout their financing process, interested parties' transactions and rapid change in ownership and board composition.

Among the proposed solutions for such failures, as regulated in recent years for public companies, is the implementation of a recommended corporate governance code (RCGC), which was intended to impose corporate governance rules in companies to secure shareholders' investments. While RCGC was intended for public companies, many organizations, including the OECD report for private companies and various venture capital firms, call for the adoption of RCGC in startup companies.

This article presents the fundamental issues in startups which call for the adoption of RCGC: the principal-agent problem, numerous conflicts of interest and misalignment of interest between the founders and the investors (and amongst the investors) regarding the company's management and future.

It reviews the possible application of Israeli and global corporate governance doctrines to startups, covering empirical and economic studies that examine the benefit of RCGC to the value of startups and reducing the cost of raising capital, and research and position papers that call for the adoption of RCGC in startup companies. It also analyzes the clashes between the startups' need for flexibility and the benefits and importance of adopting RCGC.

Lastly, the article presents various RCGC models that have not yet been introduced in academic papers, which can be adopted in startups. These include increasing the number of outside directors (to enable a casting vote in the event of founders-investors dead-locks as well as to provide an impartial mentor for the founders), adopting procedures for board meetings and increasing their frequency, and amending the controlling and management rights in the company as a factor of the expected return on investment.