

Corporate Governance

for

Early-Stage Innovative Companies

A PRACTICAL RESOURCE GUIDE

CENTER *for*
FINANCIAL
INCLUSION

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FMO
Entrepreneurial
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Executive Summary

Featuring candid insights from leading investors, executives, academics and development finance professionals, this governance resource is dedicated to helping board directors and executives/founders navigate challenges of steering a growth-stage, innovative company toward success. This resource can be summarized as follows:

- It is important for early-stage companies, especially innovative ones with exponential growth and market disruption potential, to be proactive about governance by ensuring a strong board is in place before periods of growth and important inflection points occur.
- Boards need to ensure investors are aligned on social mission and values.
- It is important for the role of the board and the role of individual board members to be clearly defined and understood from the outset. This means that investor board members need to be neither too involved in operations, nor merely fulfilling an obligation to have a board seat.
- The role of boards will evolve as a company grows and innovates, but strong, well-functioning boards add value at every stage of a company's growth and development.
- Board meetings should to be held at regular intervals, and attendees should “do their homework” and be prepared to actively participate.
- Having a board provide “checks and balances” doesn't necessarily mean slowing down growth or innovation. Strong boards challenge founders, make important introductions, partner in growth, and ultimately make a company more sustainable for the long term.

Goals of This Resource

1. For founders and leaders of innovative companies: **To raise awareness about the importance of strong governance structures early in the life of innovative companies serving base-of-pyramid clients.**
2. For investors and independent board directors of innovative companies: **To set realistic governance expectations and standards in terms of the complexity and requirements they should have for boards at various stages in a company's growth.**
3. For the industry: **To serve as a key reference to help formulate these structures and best practices, and to align expectations.**

What this Document Is...	What this Document Is Not...
<p>A guidance document. This document offers suggestions on how to form, manage and structure a board in an innovative company optimally.</p>	<p>A be all and end all. Boards take on many forms and structures, and this document is not exhaustive in breadth or depth of company types or issues faced.</p>
<p>A discussion starter. The quotes here are candid and may be disagreed upon – and that's the point!</p>	<p>A magic bullet. This document does not offer one-size-fits all recommendations to overcome challenges.</p>

Contributors

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Ezra Mannix is the Digital Content Strategist and Editor at CFI. He manages the CFI Blog and CFI's social media channels, among other responsibilities.

About the Center for Financial Inclusion at Accion

CFI is an action-oriented think tank that engages and challenges the industry to better serve, protect, and empower clients. We develop insights, advocate on behalf of clients, and collaborate with stakeholders to achieve a comprehensive vision for financial inclusion. We are dedicated to enabling 3 billion people who are left out of – or poorly served by – the financial sector to improve their lives.

www.centerforfinancialinclusion.org

@CFI_Accion

About FMO

FMO is the Dutch development bank. FMO invests with the aim of enhancing local prosperity in places where this is needed most. FMO focuses on the private sector in the following three industries: Energy, Financial Institutions and Agribusiness, Food & Water. The role of FMO extends beyond financing, as the challenge and support businesses to meet high international standards regarding the welfare of people, corporate governance and the environment.

www.fmo.nl

@FMO_development

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Background

The impact investing space continues to evolve to include new players, more digital channels, and increasingly innovative models. As the number of innovative, growth-stage companies serving the base of the pyramid increases, these companies – spanning a large variety of growth stages—have tremendous potential to be revolutionary and disruptive. The structures and processes used to provide governance oversight to these innovative companies warrants further examination and special recommendations because there are specific issues—from regulatory issues to how often to schedule meetings—to consider with regard to innovative companies given their potential. Disruption and innovation notwithstanding, however, there will always be core governance “best practices” to guide all institutions, even if the role of a board evolves drastically over time.

CFI and FMO have partnered to develop a governance resource for early and growth-stage innovative companies. An *innovative company* is defined in this document as one that has a value proposition that has never previously been offered at scale or is wholly different from existing solutions and that supports the proliferation of inclusive finance. It may do so through direct product offerings of its own or through services provided to other companies in the market. This publication focuses on creating an awareness of the critical role of governance and urges a “call for action” for growth companies to focus earlier, rather than later, on building strong governance structures and practices than what is currently often the norm.

Why Focus on Governance for Innovative Companies?

It is particularly important to provide innovative companies with specific benchmarks and insights as they manage the different stages of growth, since:

- Growth can happen quickly, and it is important to ensure that the proper controls and processes are in place *before* it occurs;
- Growth often requires additional capital and the need to attract new investors who may (and should!) want to see strong governance processes and procedures in place;
- Governance practices should be in-line with investor expectations throughout the life-cycle of a company;
- Aligning investor expectations can be particularly challenging for innovative companies that may need to pivot their business models quickly;
- It is important to identify the right moments to establish certain practices without creating boards that are either too weak or burdensome for the stage of the company;
- Governance improves transparency, particularly if there are strong founders in the business
- It instills a culture of best practices, even if a board is only partially implemented
- All in all, corporate governance should be fit for purpose.

“In a changing world, governance will continue to be key.”

Audience

Primary

- Founders/managers and board directors of early-stage/growth-stage fintechs and social organizations
- Development finance institution (DFI) professionals
- Donor organizations

- Shareholders and/or investors in start ups

Secondary

- International development professionals – including staff at non-governmental organizations (NGOs), governmental and intergovernmental agencies – working to advance financial inclusion
- Academics
- Regulators
- Traditional financial service providers looking to serve base-of-pyramid organizations or clients
- Students and others with a general interest in social impact and financial inclusion

Methodology

Through direct peer testimonials, this resource demonstrates the importance of “getting the board right” from the start in order to survive and thrive. After an introductory discussion, the information presented is divided into nine principles, providing easily digestible and actionable governance advice.

Leveraging the networks of CFI and FMO, this learning tool incorporates the (sometimes divergent) perspectives of a wide variety of industry practitioners, including the following stakeholders: founders, angel investors, venture capital investors, board members, senior management and others – the focus always being innovative companies serving the base of the pyramid and making sustainable contributions to local economies and societies. The terms “board member” and “board director” are used interchangeably.

Stages of Company Growth

I. Seed stage (Pre-Series A)

At this early stage, many companies need understanding of the basics of board management: how often to schedule meetings, what information to provide, taking useful minutes, being clear about follow-up actions and who will track and, especially, who will find the bandwidth to get this done. Board management is typically not a pressing priority, though those who get basics in place will realize early value. Advisory boards can be formed at this stage as a “pre-board” (see Principle 2).

II. After Series A

With investment comes greater attention to pulling together the elements of a functioning board. Most start with five members: two founding team members, two investors, and one independent director. Finding the right independent director is not easy particularly in markets where tech talent is thin. This is a common problem. Since the board that comes with investment is determined by factors such as capital provision or representing the founding team it’s the beginning challenge of assembling a group which matches best to the technical, regulatory and customer issues of a particular market.

III. After Series B

After the second round of investment board priorities become more complicated with strategic issues. These issues include growth and new investment initiatives; considering potential partnerships; remuneration and compensation; retaining top talent, which can be exceptionally hard in some markets; financial tracking and planning; and fundraising. This is also when finding board members with specialty skills, such as a deep knowledge of local regulatory issues, becomes particularly important.

See also Annex 1: Maturity Matrix.

Introduction: Evolving Governance Expectations

One of the main issues unique to innovative companies is that there appears to be a discrepancy between investors about the importance of governance processes and procedures. Some investors feel very strongly about ensuring solid governance principles are in place while others – both newer and veteran investors – seem to either take a “check the box” approach to governance, or place a lower value on board structure and governance principles and practices (and therefore do not ask for them).

Some innovative companies, because they are so attractive to investors, seem to be able to get away (almost right up to an IPO) with having informal governance structures, processes, and procedures. However, even the most successful innovative companies are questioned about corporate governance from a very early stage.

“I believe in the soundness of good governance principles. Good governance principles are not going out of style or becoming a thing of the past. It may be more fluid but the principles are the same.”

Innovative companies see the value in having boards for advice – and, more importantly, for very specific areas of expertise – but they don’t always see the value in the formalization and structure of boards. To be sure, the priority for a company is to have a good, high-value investor who can give advice. But part of what makes their value high is a strong commitment to governance oversight as a formal structure.

The following recent dialogue illustrates the differing and sometimes conflicting perspectives and experiences.

- **Entrepreneur Perspective:** “We meet once a quarter solicit feedback on board agendas, have a once-a-month call on key performance indicators. We’re sharing. What more do you want from us?”
- **Investor Perspective:** “We may be less concerned now with a formal board structure – at least with the earlier stage companies – but my assessment of the willingness of the CEO to be transparent and to share both good and bad news on a regular basis is key. A negative assessment of that transparency is enough for me to pass on an otherwise strong investment.”

The director and board are discussing the same topic: governance expectations. But while the entrepreneur is focused on *outputs* (making sure she has checked off all the tasks on a to-do list), the investor is thinking about the *outcomes* of these actions, i.e., looking for signs as to how transparent the company is.

Principle 1: Innovative companies should require that board members show up, be prepared, and engage with the work.

Boards should be formalized as early as possible in the life of the organization. But this doesn't mean having a board just to have one. It may be scheduling, sticking to and carrying out fruitful, productive meetings. Founders and directors alike are very busy, and meetings tend to be postponed repeatedly. Formalizing board meetings and having a clear agenda will keep everyone on task and engaged. The board directs and guides the management of innovative companies, so this keeps entrepreneurs on the right track and focused on agreed upon plans and priorities.

Also, just as a good student studies copiously prior to class, board members ought to spend at least two hours preparing for each hour of a board meeting. And like a good participatory student, a board member of an early-stage company should be able to actively participate and guide the entrepreneurs during the meeting. Examples of this "in class" support are prioritizing efforts, challenging assumptions and keeping entrepreneurs focused by setting adequate key performance indicators (KPIs). Board members should always stand ready to take on assignments and see them through without constantly having to be reminded. And – not to belabor the school analogy – just as a syllabus is prepared at the beginning of the course, so too should the company of the board put together a board package of meeting schedules, financial information, strategic planning documents – and whatever other information deemed crucial – should be given to incoming board directors.

TIP: Follow the "three strikes, you're out" rule if you must postpone meetings. Two is the maximum amount of times you can put off a meeting without seeming disinterested or unprofessional.

"For such small companies, I would think that a one-hour conference call on a monthly basis with the two or three directors, in lieu of a formal board meeting, would be sufficient and set a good precedent. But I am reminded that every director should expect to spend two or more hours in preparation for each hour of a board meeting."

Lastly, entrepreneurs might have blind spots, and their passion can lead to dominating meetings. Engaged board members can provide meaningful and valuable advice, but they cannot do so if they are absent or continuously checking their phones during meetings.

See the referred resource in Annex 3 for more on structuring board meetings and expectations from directors.

Principle 2: Understand that early-stage company boards are different from mature company boards.

"The board should help entrepreneurs and investors. It should not be a burden that prevents a company to innovate, to grow or to be agile."

Entrepreneurs are dedicated to their ideas and do their utmost to make the business a success. More often than not, establishing basic corporate governance structures is not at the top of their agenda. It might be perceived as a burden, and its value to the company is not always fully understood. A well-established board that is fit for purpose given the development stage of the company is, however, instrumental for the success of the company.

Roles are different when a company becomes more established. In more mature companies, the board traditionally has an oversight role with a strong focus on strategy, financials and internal controls.

The role of the board for early-stage companies is, however, fundamentally different from that of more mature companies: it should not be a burden that prevents a company from being able to innovate, to grow or to be agile. Entrepreneurs should not be bothered too much with detailed minutes, detailed board packs and preparing lengthy memos. Thus, the board of early-stage companies should be able to challenge and guide the entrepreneurs, and they should bring skills that support the entrepreneur (e.g. network, business development). In the development of companies, the board role changes to a more oversight role when an institution is well-established. That said, boards should still implement at least financial oversight and transparency to the same extent as mature boards.

“Those innovative companies getting away with not having more formalized governance at the B and C-levels are able to do so because they are rock stars and investors are beating down the doors because they are such valuable investments.”

Advisory boards can be useful when founders are still not sure if they are ready to form an official board and want to get a sense of how it would be to have a group of outsiders provide additional input on strategy in particular. This goes for founders that did not receive investor funding that came with a right to appoint a director, of course. An advisory board, however, should not be a long-term governance structure.

Principle 3: Expectations of board members should be clear from the beginning.

“I don’t have the liberty of making mistakes and learning because there is a heavy seven set of eyes watching.”

An investor adds value directly through his/her investment in the company, of course. But an investor often expects to add value in other ways in order to ensure growth and profits, and company founders want investors to support their vision. What often happens, however, is that expectations on both sides are not clearly communicated early, leading to frustration from all parties. This not only helps established board members, but also helps convey expectations to potential new board members, and provides honest, realistic expectations for onboarding once they agree to join.

That doesn’t mean putting in place heavy reporting requirements or complex committee structures, but it does mean clarifying roles and establishing parameters for constructive discussion and decision making, such as Robert’s Rules. Those parameters can take the form of a committee or an advisory board to talk through challenges.

A value-add investor at this stage understands that the business will pivot often and demands agility from investors and founders alike. On the other hand, investors want to know that the CEO and his/her team are willing to communicate clearly and “share the dirty laundry.”

Principle 4: Having organized board committees too early is not recommended, but thinking about future committees is.

In the board of mature companies, it's typically the board committees that are the workhorses of the board. Allocating specific tasks to a board committee and discussing specific topics in a smaller group can make the board more efficient. This is particularly true with larger boards, where it is not most efficient and effective to discuss all items in the wider board. Once the board of a company grows it is important to timely consider establishing committees to improve board effectiveness. This is typically the case once the board has more than five members.

Early-stage companies typically have small(er) boards, and committees may not be warranted yet because it makes board structures unnecessarily complex. Rather, an important value of boards in early-stage companies should be in the diversity of views and support for agile decision-making and action. Subject matter experts tend to cluster in committees (i.e. financial service professionals in the audit committee) where out-of-the-box views may be given more consideration.

TIP: Management should think about specific board committees for when the company matures and communicate this to the board. It shows investors you are organized and have thought through governance structures. See Annex 3 for more on committees.

In more regulated industries (e.g. financial services), on the other hand, there might be a requirement to have specific board committees (e.g. audit committee). In those cases, a company has no choice but to comply, especially where the size and reach of a company is not considered in regulations.

Principle 5: Having the right kind of experience on the board is key.

Board members should bring skills and experiences that support and compliment the management team. Entrepreneurs might have brilliant ideas, but lack the required network and business development skills, and may have a limited knowledge of the expectations of (future) investors. Board members should bring missing skills and experiences to the table that are instrumental to the longer-term success of the company. Board members typically add value by facilitating future capital rounds, opening up access to a network and bringing expertise in business development.

At the growth stage, “scalers” are one type of desired board member. Scalers are investors who may not be subject matter experts but do have experience scaling a company and thinking and acting strategically. Their modus operandi is “we can get you through series A and B with our connections.” Another value-add board member is someone based in a served market, because he/she understands intimately the company’s operating environment, including political and regulatory challenges.

Principle 6: Board members should have a passion for impact and be aligned with company values.

Any company serving vulnerable populations living at the base of the pyramid must be particularly focused on the impacts of their products and services – both positive and negative. As with any company, having a deep understanding of your clients, and designing client-centric products and services makes sound business sense.

However, some investors do “check the box” due-diligence and don’t ask detailed questions about actual social impact. To counteract this, a strong governance structure can help to ensure that:

- there is a sense of social alignment among investors,
- the social mission of the company is truly embedded into the company’s practices,
- the impact being measured is tailored specifically to the company,
- the company doesn’t drift from its core social mission as it grows.

“If you figure out a system where you can gather lean insights, pull it together in a way that tells a really coherent story, and allows your board to be able to engage with that story over time, that empowers the board to be able to better support you.”

Principle 7: It is the role of the board to push back when necessary.

“It felt like betrayal, but ultimately, I saw a union of thinking from a united board. That made me realize that I was standing on the wrong side of the bridge. Since the pivot, business has grown significantly. It’s hard to admit it, but the board forced that change. I would not have got here any time soon if left to my own devices.”

A lot of innovative companies are dominated by one or two very strong individuals with a very clear vision. Sometimes, boards run the risk of that vision dominating everything. If there are not enough people pushing back and challenging governance, things can turn into a dictatorship – and future investors do not want that. This is not to say that a board should always put up roadblocks and slow things down, because innovative companies need to be nimble, but the board must not be afraid to challenge ideas or perceived realities of a founder.

As one interviewee put it: “The board is the biggest bane and not adding value – on both sides. They were too close. The investor needs to realize that their hand-holding is for them and not helping the innovative company.”

Likewise, founders and entrepreneurs should not be afraid to receive criticism. When blood, sweat and tears are spilled leading an innovative company, it’s easy to resent criticism or dismiss it as ill-informed. It’s nothing personal. The director has the company’s best interests in mind – otherwise she/he wouldn’t be there!

For more on the role of boards in challenging management, watch CFI’s “Governance for Startups” online. See Annex 2 for the link and a summary.

Principle 8: Have a concrete plan and timeline for the evolution of governance structures and roles.

Like all companies, it is important that the corporate governance structures of an early-stage company are fit for purpose. The structures should reflect the ownership model, size, complexity and risk profile of the company. Those structures should further mature as a company grows, and this is particularly the case for fast growing companies.

As institutions mature, their boards gradually formalize functions previously executed informally. Examples of this include creating committees of the board to undertake detailed work in support of board decisions, developing a board manual, or formalizing the CEO's annual review process. Over time, a board of an early-stage company, when successful, will develop into a mature board. It is difficult to generalize about what acceptable governance looks like at different stages, but organizations should continuously assess if their governance structures are fit for purpose. Also, companies need to recognize the need to further professionalize the corporate governance structures as the company matures.

The Maturity Matrix (Annex 1) provides a view on a board maturity model. It is important for a company to recognize that it should think about its board sooner rather than later. A fit-for-purpose board is a strong asset to the company, and the lack of an appropriate governance structure is a real liability.

Principle 9: Add an independent board member(s) as the company grows.

“In the development of companies, the board role changes to a more oversight role in those cases where an institution is well established.”

The initial board of a company is usually comprised of the founders and one or two early investors. This board is typically the first formalized corporate body that performs work that was previously carried out informally.

The board will grow once more investors come onboard as additional funding rounds are completed. The founders typically only have a single seat after series A, with the investors taking the other seats. A board will become more professional as it matures, which would typically be the moment where a first independent board member comes in. The independent board member is best positioned to act exclusively in the best interest of the company and should be a driving force behind further professionalization of board practices.













Final Thought

“From a governance point of view, you simply have to do what is right, right from the start, rather than wait until much later. Sometimes, for startups, they tend to think that getting the governance structure right is expensive, that it takes too much time, but I think that it's worth their while to make sure they get it right.”

ANNEX 1

Governance Maturity Matrix

This typography outlines the stages of a board's development and provide suggested benchmarks on appropriate governance structures and practices at various stages of maturity and funding.

		 GOVERNANCE MATURITY MATRIX			Best Practices <ul style="list-style-type: none"> • Monthly calls, quarterly meetings, annual retreat • Should have Director & Officer insurance even at seed stage
		Seed	Early	Growth	
Company Profile	 Revenues	Early Revenue	Modest but growing	Breakeven	
	 # of Employees				
	 Funding	Seed --- A --- B	Seed --- Series A --- B	Seed --- A --- Series B	
	 Year(s) established	0 - 3	3 - 8	8+	
Governance Characteristics	 Size of board	3 - 5	3 - 5	5 - 7	
	 Composition	Founder(s) and investor(s)	Founder, investors, promoters	Add independent, usually founders get diluted between A and B	
	 Member profile	Understands agile and lean design and development, sector expertise	Subject matter experts with expertise in AI, machine learning, underwriting, digital marketing, payments, etc.	More traditional investors with expertise in governance, sustainable growth, and risk management	
	 Committees	Audit	Audit	Nominating, audit and compensation	

ANNEX 2

Video: “Governance for Start Ups”

Africa Board Fellowship Roundtable: *Governing in a Digital World*. Addis Ababa, 2017.

Published by the Center for Financial Inclusion, January 2018.

Link: <http://bit.ly/govforstartups>

This video offers additional points for executives and board members to consider.

1. **Engage with regulators.** Working closely with regulators to understand parameters, while at the same time pushing boundaries, is a delicate balancing act, but one that can pay dividends. Taboos and stigmas about how things are done should be challenged in a way that’s constructive, while for their part, regulators should eagerly embrace digital transformations.
2. **Ensure board diversity and independence.** With many young fintechs dominated by one or two people with strong visions for the future of financial inclusion, it’s imperative that board members push back and challenge founders in the right way and implement checks and balances – all while keeping ensuring nimble action. These professionals should have access and experience in emerging markets. This can give tech-oriented executives a chance to step out of the “echo chamber” and provide real time feedback for what the business climate is like, who they should get to know, and how to make solutions culturally relevant.
3. **Consider partnership potential.** Innovative startups should understand what incumbent businesses are doing and the gaps in their business models in order to find opportunities to collaborate. Figure out what’s core and non-core in a business model and partner with other businesses in those non-core areas. It’s also helpful to determine imperatives for success in partnerships after determining where they can be forged.

Interviewees

Rohit Acharya, Co-Founder and Chief Data Scientist, First Access

David Cracknell, Global Technical Director, MicroSave

Buhle Goslar, Director of Customer Intelligence, JUMO

Kelvin Kizito Kiyingi, Deputy Director of Communications, Bank of Uganda

Paul Lamont, Director, Digital Services, Africa, Accion

Patrice Nkhono, Board Director, FDH Bank

Emil Sjoblom, Chief Commercial Officer, BelCash

ANNEX 3

Slide Deck: “Best Board Practices for Startups/Seed-stage Businesses”

Accion Venture Lab

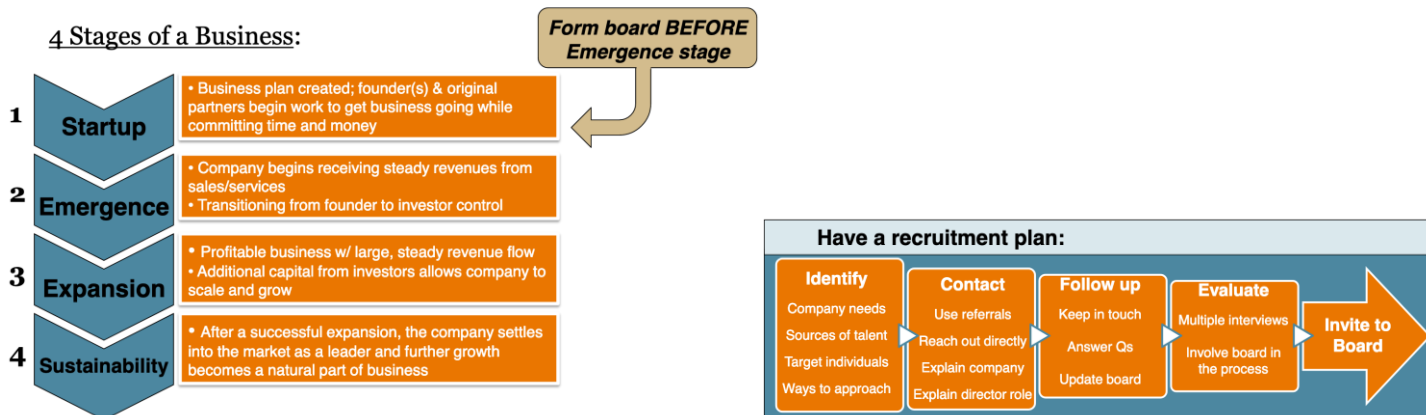
Link: <https://www.accion.org/best-practices-for-building-and-leveraging-a-startup-board>

Created by Venture Lab, Accion’s seed stage investment initiative, this resource also offers early-stage businesses helpful content to guide the creation and leveraging of a board, structuring committees, recruiting new members, and more – all with copious charts and graphs (see examples below). It also provides more detail on board meetings, including tips for creating agendas, what items to include in a board deck, how to take minutes, and so on. “Best Board Practices” is divided into three parts:

- Building & Structuring Your Board
- Leveraging Your Board
- Board Meetings

Selected Charts and Graphs

Board Basics – When to Form your Board



As You Grow – Forming Committees

