Corporate Governance in Startups

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Abstract This study aims to examine how Spanish startups disclose information on corporate governance, by empirically analyzing a set of startups in this context. In particular, this chapter focuses on four startups from Science Park at the University of Valencia, exploring whether the Spanish startups fulfill the recommendations of codes of corporate good governance. Thus, we explore such characteristics of corporate governance as the size of the board, the number of advisors to the board, the board's gender diversity, and questions relating to two Sustainable Development Goals (SDGs). The results of the startups completing a questionnaire emphasize the need to continue work in the field of corporate governance, to assist startups with a long way to go. The corporate boards should consider implementing codes of corporate governance and corporate social responsibility activities in their companies.

Keywords Corporate board practices · Startups · Gender diversity · Internal audit committee · External directors

1 Introduction

The financial scandals that occurred in the last decade, the worldwide financial crisis, and the coronavirus pandemic have called into question financial reporting quality, transparency, disclosure of nonfinancial information, and the financial system generally. However, both national and international regulators have elaborated a set of corporate governance recommendations and regulations to mitigate or reduce these problems. Among such regulations are "codes of corporate good governance" (CCGs) that regulatory bodies have developed. The Cadbury committee (1992) defined corporate governance as the technique or system for supervising and managing firms. In this sense, corporate governance comprises the methods and actions

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by which a board of directors, senior management, or a chief executive officer (CEO) directs and controls the firm.

Corporate governance plays an important role in the establishment of ethical and social practices throughout the firm's structure and its relations with creditors, customers, employees, shareholders, investors, and regulatory bodies. Moreover, it enhances the legal compliance recommendations and prevents unethical and illegal firm behavior (Al-Malkawi et al. 2010). Most empirical literature on corporate governance has examined characteristics of listed companies on this field, theoretically and empirically, whether in a Spanish or an international context.

A startup is a newly developed or young company that presents great growth potential and markets services and products using information and communication technologies. In this sense, Kollmann et al. (2016) define startups as companies whose (highly) innovative technologies and/or business models characterize them. Usually, they are less than 10 years old and have increased or are trying to increase their number of employees and/or sales. The Spanish Association of Startups defines the term "startups" as an independent technology-based project or company that appears with the mission of validating a clearly innovative business, product, or service model that has high growth potential. In this sense, Fernández and Beukel (2017) explain that the most important characteristics of startups are the absence of routines and their flexible encouragement of innovative skills. These factors are very important for managers who monitor these companies. They must emphasize creativity and engage with partners to get the legitimacy and resources they lack.

This chapter presents Spanish startup cases, specifically the four startups in the Science Park at University of Valencia study, and extends the corporate governance literature by testing whether the Spanish startups comply with the recommendations on corporate governance. This chapter will explore the importance of several corporate governance variables, such as the size of the board, its gender diversity, and two SDG-related questions. Additionally, a descriptive analysis such as the one in this study is more important in a country like Spain, where studies examining attributes of the corporate governance system in its startups have not proliferated.

2 Some Aspects of Startups in Spain

Following the Informa report (2021), Spanish startups represent 4% of the total number of Spanish companies that remain active, out of the total number of businesses created between 2016 and 2021. In this sense, the report noted that Spain already has 23,383 startups, a 3% increase over the previous year. Moreover, between 2016 and 2021 in Spain, 570,000 companies were created, of which 25,452 were startups, based on their development of innovative technological activity. In 2021, the 23,383 startups were among the 423,508 active companies. Moreover, about 95% of startups are micro-companies, and only 0.87% are large companies.

Regarding location, the Informa Report (2021) explains that Madrid represents 27% of the population, followed by Catalonia with 22.70%. Melilla is the

community with the lowest proportion at 0.04%. The Valencian community represents 10.17%. The Spanish startups' industries mostly relate to developing technological activities. In this classification, high-technology services represent 79.52%, manufacturing activities with high-level programming activities represent technology at 13.96%, and only 3.25% pursue activities that are not technological. Spain's startup age is 2.3 years under the European mean and represents 2.4%, compared to the United Kingdom (2.7%), Germany (2.4%), France (2.4%), and Italy (2.4%).

Moreover, the National Observatory of Technology and Society (ONTSI) included in its 2019 report that in 2018, the proportion of female founders of startups was 15.6%, the same as the European average. Of the large European economies, the most representative value for this statistic is the United Kingdom's with 18.8%, followed by France with 20%. Alarcos (2021) explained that the typical female digital startup (i) was a microenterprise less than 5 years old, (ii) employed between 0 and 4 people (70%), (iii) was not part of a predominant industry, and (iv) did not reach one million euros in turnover (92%). In fact, in that regard, a significant number reported less than 100,000 euros (72%).

3 Good Corporate Governance Practices in Spain

The basis of the Spanish corporate governance system is stronger ownership concentration, fragile investor protection, less developed capital markets, less strict insider information regulations, and a one-tier board system where executives and non-executive directors serve on the same board. The ownership concentration implies that majority shareholders who introduce institutional directors onto corporate boards dominate the listed companies (De Miguel et al. 2004). In Spain, institutional directors are called "gray" or "proprietary" directors. According to the Unified Code of Corporate Governance (2006), these are the "directors who own equity stake above or equal to the legally determined threshold for significant holdings, or otherwise appointed due to their status as shareholders."

The higher ownership concentration led to the Spanish corporate governance system differing from other countries that present widespread ownership, such as Japan, the United Kingdom, or the United States, where it is less common for institutional investors to designate institutional directors on corporate boards. Therefore, the Spanish capital markets act as controlling shareholders and directors on boards, apart from acting as company funding sources. Pucheta-Martínez and García-Meca (2019) found that Spanish boards had, on average, 21% institutional directors, of whom around 7.1% represented financial entities and insurance firms (pressure-sensitive institutional directors), and 13.9% represented mutual and investment funds (pressure-resistant institutional directors). In contrast, Jiang and Liu (2021) reported the evolution of the presence of institutional directors in the United States from 1998 to 2011, where, on average, only 3.99% of directors are institutional directors. This situation explains one of the main problems in the Spanish companies, namely, the expropriation of minority shareholders' wealth by major

shareholders (Shleifer and Vishny 1997). In Spain, the ownership structure, investor protection, and litigation risk for directors and auditors may differ between civil and common-law environments (La Porta et al. 1998, 1999).

Spanish regulators elaborated a series of Good Corporate Governance Codes to enhance the Spanish situation. In 1998, Spanish regulators approved the Olivencia Code, whose main purpose was to improve the business context by aligning the interests of managers and shareholders. In 2003, the Aldama Report updated the Olivencia Report and focused on transparency of principles, security in listed companies and the markets, and administrators' loyalty. Law Number 26/2003, of 17 July 2003, on the transparency of listed companies, modified the Securities Market Act (*Ley del Mercado de Valores*) and the Public Companies Act (rewritten text of the *Ley de Sociedades Anónimas*), which attempted to change the public firms' transparency and adopted many corporate governance recommendations.

In 2006, the Unified Good Governance Code (UGGC) also called Conthe Code (2006) was elaborated, updating and harmonizing the recommendations included in the Olivencia and Aldama reports. In the Conthe Code (2006), the statutes are based on the recommendations concerning directors, corporate boards, and board subcommittees. In recommendation 15, this code argues the necessity of including female directors on corporate boards, to attain equity between men and women. In this respect, Spanish standards allow companies to decide the implementation of these recommendations and their intention of "compliance or explanation" principles, to enforce the corporate governance suggestions without sanctions for those companies that do not comply. To improve the recommendations that the new legislation affected, the *Spanish National Securities Market Commission* elaborated a partial update of the Unified Code in June 2013. That year, an experts commission elaborated the Good Governance Code for listed companies (hereafter the Good Governance Code 2015), based on policy reforms and initiatives to ensure good corporate governance. Finally, in June 2020, the *Spanish National Securities Market Commission* published the Good Governance Code for listed companies with the main goal of enhancing the relevance of nonfinancial information and sustainability, the inclusion of female directors on boards, the clarification of directors' remuneration, and greater attention to reputational and nonfinancial risks in general.

Spanish good corporate governance codes promulgate a set of recommendations that modify the functions, activities, and structure of the board of directors. Concerning such aspects, a one-tier board structure characterizes Spanish-listed companies, where the board of directors assume the control functions of the company, ensuring the alignment of interests between shareholders and managers (Kang et al. 2007), leading to a decrease in information asymmetries (De Andres and Vallelado 2008), favoring compliance with standards and regulations, and connecting the firm to the outside context (Carter et al. 2010). Hence, the corporate board is an important corporate governance tool for monitoring managerial behavior (Fama and Jensen 1983).

The corporate board should carry out its duties with unity and separate judgment, considering all the firm's shareholders equally (Conthe Code, 2006). According to the main functions and competencies of the board, the eighth recommendation of the Conthe Code (2006) explains that its general functions are based on connecting the company with its shareholders (disclosure information), controlling its managers, and promoting the company's strategic policy. The Good Governance Code for listed companies (2020) recommends including between 5 and 15 members on corporate boards, and the tenth principle explains that the selection policy should consider a board composition that balances age, experience, gender, and knowledge. Regarding board composition, all codes recommend the inclusion of a large number of non-executive directors and a combination of independent and institutional directors, while the proportion of executive directors should be minimal, due to the complexity and the proportion of ownership interests they may control. In this line, the chairman is responsible for corporate boards acting efficiently. The president communicates the meetings, participates actively in the board discussions, and ensures that the directors have all information on time and correctly. However, there is an open debate on whether the chairman should be the same person as the CEO since, in that case, the necessity of including safeguards to reduce the risk of concentrating power in a single person, as the fifth recommendation of the Olivencia Code indicates (1998), becomes impossible. Another recommendation of the codes is the inclusion of female directors on corporate boards. The Conthe Code (2006) supported and enhanced female presence on boards of directors since the previous reports did not support this idea. Moreover, this premise was implemented with Act 3/ 2007 of 22 March for "Effective Equality between Women and Men" (LOIMH), whose article 75 proposes the equitable nomination of female and male directors to corporate boards. This act advised Spanish corporate boards of listed firms to consider the inclusion of a gender quota of 40% by 2015, although this proportion was not possible. In 2015, the Good Governance Code increased the proportion of gender quota to 30% by 2020, but the boards did not obtain those results. For this reason, the Good Governance Code (2020) recommended that boards of directors of listed Spanish firms reach a gender quota of at least 40% by 2022. According to Instituto de las Mujeres (2021), the proportion of female directors on IBEX35 firms' respective boards increased to 37% in 2020, a lower proportion than expected.

4 Startup Case Study in Corporate Board Practices in Spain

This section presents a descriptive analysis of some corporate governance variables in the context of Spanish startups, as well as the scope of the SDGs. Notably, a great amount of data and information on corporate governance is available for listed companies. However, such data and information are very limited for startups, due to their nature. Most do not prepare or provide annual information on corporate governance activities or, if they do, they do not make these reports public, so processing them for incorporation into databases is difficult.

Table 1 Results of the survey of good corporate governance practices for Spanish startups

	Question 1	Question 2	Question 3	Question 4	Question 5
	How old is the company you manage?	How many male managers are there?	How many women managers are there?	How many external directors are there?	The president is man or a woman?
Startup 1	6	1	2	0	Man
Startup 2	1	1	0	0	Man
Startup 3	3	8	2	0	Man
Startup 4	6	2	1	0	Man

	Question 6	Question 7	Question 8
	How many times a year does the board meet?	Does it have an Internal audit committee?	Does it have a Code of Ethics related to the protection of the environment?
Startup 1	24	No	Yes
Startup 2	1	No	No
Startup 3	24	Yes	Yes
Startup 4	12	Yes	Yes

Source: Compiled by authors

Table 2 Results of the survey on the scope of the SDGs for Spanish startups

	Question 1	Question 2			
	Have any of the Sustainable Development Goals (SDGs) been included in the Company's purpose or mission?	If so, indicate the SDG(s) you are implementing or have implemented			
Startup1	Yes	SDG 5	SDG 12	SDG 14	SDG 15
Startup2	No, but we will include them	SDG 8			
Startup3	Yes	SDG 3	SDG 9	SDG 10	SDG 11
Startup4	Yes	SDG 14			

Source: Compiled by authors

The sample for this analysis comprises four Spanish companies belonging to the technology sector for the year 2021. These companies present heterogeneous characteristics, such as experience, size, age, number of employees, and turnover volume. Data on these companies came from one of their managers participating in a survey on good corporate governance practices and SDGs (see Tables 1 and 2).

Analyzing the results of the survey through the items that appear in Table 1, in general terms, shows that the companies had a very short life span. This is obvious since this type of technology-based company, as a startup, was not very old. Specifically, two of these companies had reached a maximum age of 6 years, and the rest show very limited experience.

Analyzing gender diversity within the management teams shows scant representation of female managers in positions of responsibility. Specifically, for one of these startups, the presence of eight male managers outnumbers only two female

managers. Only one case shows twice as many female as male managers. In general, only 30% of the members of the average corporate board are females. Moreover, in all the startups in the sample, a male occupies the president's position. This results in these startups not accomplishing the aims of the Good Governance Code (2020) 15 recommendations for a gender quota of at least 40% by 2022.

As main findings, the low rate of female representation on the board for the group of startups in Spain is remarkable, showing that the male profile still has major importance on corporate boards. The evidence is very different for large companies and, mainly, for the listed ones, with a much greater presence of female directors, bringing beneficial effects of female management on the board for firm value (Campbell and Minguez Vera 2010; Mínguez-Vera and López-Martínez 2010; Martín-Ugedo et al. 2019).

Respecting external directors providing their experience and advice for improving the proper functioning of the company, as expected, these companies are just starting or have little experience in the sector, so they do not have external directors. The findings obtained in this study contradict recommendation 15 of the Good Governance Code (2020), which explains that the external directors should represent a large majority of the corporate board, and the number of internal directors should be the minimum necessary.

As for the meetings the board of directors holds, as the company experience increases, so does the number of meetings. Indeed, the three oldest startups tended to meet twice a month, on average. In contrast, the youngest startup only called one meeting per fiscal year. However, the outcomes reveal that startups are far from meeting at least eight times a year, recommendation 26 of the Good Governance Code (2020).

The internal audit committee plays a relevant role in monitoring, controlling, and supervising aspects that relate to accounting, auditing, and both financial and nonfinancial risk management. Interestingly, not all of the largest startups by age have this commission. Only two out of three have it, and, predictably, the youngest does not. In this case, we cannot assert that greater age implies the existence of an internal audit committee; that depends on the members who integrate corporate boards.

Also deserving special attention, given the idiosyncrasy of these companies, is the existence of corporate ethical codes that intend the company to contribute to the preservation of the environment. In this case, all the startups that have interacted in the market for several years align with the philosophy of designing and executing an ethical code that largely contributes to their survival over time. On the contrary, the youngest startup does not have an established code of ethics, but from our point of view, it is a matter of time before they draw one up.

On the other hand, regarding the questions in the survey related to the SDGs, practically all the startups in our sample are strongly committed to the United Nations' 2030 Agenda (see Table 2). Indeed, all these companies have incorporated the execution of part of the SDGs into their business strategy, except for the youngest startup – despite not currently addressing them, it states that it will do so in the future. Following Good Governance Code (2020) recommendation 55, companies

develop an appropriate environmental and social policy and offer transparency information based on its development, implementation, and outcomes.

Summing up, Spanish startups are working on such aspects as guaranteeing healthy lives and promoting well-being, contributing to making equality between males and females a reality, fostering inclusive and sustainable economic growth, developing resilient infrastructures as well as promoting innovation, reducing inequality between countries, contributing to sustainable consumption and production, and supporting the preservation of the seas and their marine resources, sustainable management of forests, and biodiversity.

5 Conclusions

In recent years, researchers and academics have increased interest in corporate governance in the national and international context. Thus, this study aims to examine how the Spanish startups disclose corporate governance information. Specifically, it presents some related results for a sample of four startups from Science Park at University of Valencia. Data collected using a questionnaire that included eight corporate governance questions reported the size of the board, the number of board advisors, its gender diversity, and responses to two SDG-related questions.

The main conclusions are as follows:

(1) In our sample, the technology-based startups have a short life span. In fact, most are just starting out or have little experience in the sector. Accordingly, they do not involve an external director in their corporate management.

(2) The number of meetings the board members hold relates positively to the company's experience: the older the company is, the greater the number of meetings per fiscal year. On average, the three oldest startups meet twice a month. In contrast, the youngest startup only meets once a year.

(3) The existence of an internal audit committee depends on the members who populate the corporate boards.

(4) The same happens with the existence of corporate ethical codes to contribute to the preservation of the environment. In the case of the youngest startups, it still is a future intention; the oldest have already adopted an ethical code.

(5) Gender diversity within the management team is currently a challenge for most companies; males still predominate. Overall, only 30% of the members of the average corporate board are females. Moreover, all startups in the sample have a male president.

(6) SDGs are a concern common to the companies in the sample because all of them have already included SDGs in their business strategy or are thinking of doing so in the near future. As the previous section shows, Spanish startups are relatively young companies that need more time to include good corporate governance practices. In this sense, policymakers should encourage the startups to consider the corporate governance recommendations, to increase the number of independent and female directors in positions of responsibility and considering the incorporation of

corporate social responsibility strategies, especially the SDGs, that could increase value and enrich the firm.

Several limitations of the study should be acknowledged. First, the sample used in this study comprised only four startups from Science Park at University of Valencia. For this reason, the results obtained should not be extrapolated to other countries and periods. Extending this study to a wider sample of countries, periods, and number of startups would help to generalize our findings. Also, the variables this study used are those on which previous empirical studies of listed companies have focused, so there may be other variables that we have not considered.

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