

Founders and corporate governance part 2: Scaling your business

Executives & Entrepreneurs

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- This is the second article in a series of three, examining why corporate governance can be a worthwhile early investment for founders.
- Sustainable scaling that lasts depends on repeatable processes that don't rely on just a single founder or manager. This is where corporate governance comes in.
- In this second article, we highlight how corporate governance can help **scale** your business through two main channels: your people and your supply chain.



Source: Getty Images

You're a founder. You've validated your product. And now you're ready to grow.

Corporate governance—the structure of rules, practices, and policies that underpin how you direct and manage your company—is not your top priority. Corporate governance is a privilege for mature businesses that have the luxury of critical mass and the necessary staff to document rather than just do.

If the above statements ring true for you, we believe it is important to stop. Take a breath. And reconsider.

Corporate governance can help founders **scale** their business plan by:

- Driving commercial accountability for hiring across the company, ensuring you get the right worker, in the right job, at the right time.
- Providing a formal framework for managing the disputes arising from a growing labor force, without disrupting operations.

- Giving you the tools to balance continuity and efficiency across your increasingly complex supply chain.
- Presenting your company and its whole value chain in the best possible light to the large, multinational, and sustainability-focused businesses with whom you want to partner.

Last week we began a series of three articles examining why corporate governance can be a worthwhile early investment for founders.

In the first article, "[Founders and corporate governance part 1: Starting your business plan](#)," we showed how robust thinking, thorough documentation, and execution of corporate governance can help founders **start** their business plan.

In this second article, we highlight how corporate governance can help **scale** your business through two main channels: your people and your supply chain.

In the third article, we'll discuss how corporate governance can help **switch** your business—whether a sale, a family transition, a buyout, or a winding down.

Throughout this series, we aim to show that corporate governance is a good practice for all business owners.

Governance metrics also matter to stakeholders, a group that includes employees, suppliers, regulators, or potential investors (on the last point, please see our paper [“Three ways sustainability transparency can affect your business exit”](#)).

Remember: Corporate governance should be regarded as a living, open-ended process—one that works best if it evolves with your startup, family, and financial plan.

We advise making corporate (and family) governance a dynamic, not static, undertaking. And don't be afraid to draw on external expertise for different perspectives or alternative scenarios so that your governance plans reflect your current needs and stay resilient to uncertainty.

So, can corporate governance help *scale* your business?

Scaling is about taking what works at the microscopic level and translating it up, whether to the market, across the country, or beyond national borders.

But we believe founders would be mistaken to think successful scaling is all—or only—about sizing. With scaling comes complexity and the need for previously untapped sources of capital and talent. So sustainable scaling that lasts depends on repeatable processes that don't rely on just a single founder or manager.

This is where corporate governance comes in.

Corporate governance can help startups scale if you:

1. Develop a diverse and independent board to steer the company

Early-stage companies are typically governed by the founder and senior management team.

As the company grows, oversight responsibilities are often extended to friends and family. But while the advice of these closely connected people may seem sufficient, establishing a professionalized board that is diverse and includes independent members can improve your chances of long-term success.

The role of the board is to provide guidance and oversight—to ensure that the interests of the management and

shareholders are broadly aligned. This may not feel relevant in the early stages of a company, especially for family-owned businesses where this alignment seems natural.

Yet, setting up a robust set of bylaws and a formal board structure in the early stages of a firm's life may make it easier to adjust if you decide to accept external capital, or if you are looking toward an exit further down the line (which we will discuss in more depth in our third article).

In addition, independent board members from diverse backgrounds can constructively challenge the CEO and senior management. As we discuss below, there is ample evidence underscoring the benefits of a diverse workforce when it comes to innovation and performance, and we believe these same principles apply to the board of directors of a company.

2. Design and document policies to hire the right worker, in the right place, at the right time

Hiring and firing decisions are primarily operational ones. But governance and its tools (e.g., policies and objectives) can systematize practices and provide the guardrails management needs, particularly in periods of rapid growth.

Many startups arise from monocultures. Founders may protect their fragile business in its first stages by working with people like them. They often start a company with friends, family, or even college roommates.

Diversity, equity, and inclusion (DE&I) principles are not always front of mind for many entrepreneurs in the pre-startup and product validation stage. They may believe that starting their firm requires the singular vision, high degree of control, and perceived comfort of sameness that can result from working with “people like us.”

But what worked for starting your business is highly unlikely to work for scaling your business.



Source: Getty Images

As your company grows, you'll typically need to expand your workforce. And having the right worker, in the right place, at the right time matters.

The need for diversity of expertise, skills, and thought will rise as your business demands new roles.

Equity will become more relevant as you seek to foster teamwork and reduce division between founders (with direct economic interests of ownership) and employees (with some combination of direct and indirect economic interest, such as a salary).

And a successful scaling will likely depend on a culture of inclusion where everyone's voice is heard, teams can function productively *because of* difference not *in spite of* it, and new perspectives can be smoothly commercialized.

Yet talking about DE&I is far easier than implementing it. But in our paper "[The commercial case for diversity and inclusion](#)," we observe that data validates DE&I efforts for founders looking to scale.

Scaling your business is about seizing new opportunities quickly and managing fresh sets of risks effectively. One study found diversity can boost innovation by 20% and reduce risks by 30%.^[1]

Scaling your business is also about maintaining and ideally increasing firm-wide productivity. A 2018 study of US corporate data between 1996 and 2009 found a positive correlation between the presence of corporate policies that support LGBTQ+ workers and productivity. More inclusive firms that had supportive policies reported 3% higher productivity than less inclusive businesses.^[2]

Finally, scaling your business is about your willingness as founders to embrace new managerial talent that can fill the skill gaps and enable you to boost revenues. A 2018 study from the Boston Consulting Group found a strong

and statistically significant link between management team diversity and innovation revenues. Firms with above-average diversity delivered 45% of total revenues from innovation, compared to 26% for those firms with below-average diversity among leaders.^[3]

In truth, the talents that enabled you to build a business don't necessarily match those needed to grow a business. But the potential benefits of ceding some control to professional managers can outweigh the costs... if accompanied by comprehensive governance frameworks.

Here are two reasons we believe formalizing your hiring, development, and retention policies can help you successfully scale:

- **It drives commercial and sustainability accountability across the firm.** Careful consideration of diversity, equity, and inclusion, followed by formal policies documenting your decisions, brings (but doesn't guarantee) objectivity to your hiring. The tone from the top and the use of metrics to measure diversity and inclusion (based on the principle of *equality of opportunity*) will enable you to hold yourselves and new managers accountable for learning and improving as you scale. And it also sets the expectation that while founders own the DE&I strategy, *everyone* is responsible for its implementation.
- **It provides a formal framework to manage inevitable tensions.** Successful scaling no longer affords founders the ability to solve disagreements between friends in an informal way. The rights of building a workforce come with the responsibilities of investing in a well-designed governance framework for your people. The need for formal processes is especially important if scaling takes your business into new markets and new cultures.

For a more detailed analysis of potential corporate governance factors, please see "[The commercial case for diversity and inclusion](#)."

3. Anticipate an increasingly complex supply chain with rigorous rules and best practices

In the validation phase when the minimum viable product (MVP) was created and tested, founders may have stuck to a simple supply chain model. There may have been a lot of trial and error when finding the suppliers, vendors, or contractors needed to create the MVP. But it's probable that supply chain logistics and transparency were not major barriers to progress—coming up with the solution was!

However, increasingly complex, global, and long supply chains may not be avoidable for a scaling business.

The question for founders is how to manage this new challenge systematically.



Source: Getty Images

While the management of supply chains is a day-to-day operational process, your broad strategy toward suppliers, including sustainability objectives, may be best regarded as a governance issue.

Indeed, as we discussed in our recent paper "[Entrepreneurs: Is business efficiency becoming less efficient?](#)," founders may need to prepare for scaling to be accompanied by a heightened need for business oversight. Even global supply chain leaders reported that just 2% had visibility beyond their second-tier suppliers and 11% had none, [according to McKinsey](#).

Similarly, founders may need to formulate a rigorous plan for managing the efficiency of their working capital. If scaling involves production across multiple locations, for example, founders need to develop policies around how to prevent stock-outs in one place and excess inventories in another.

Scaling will likely have consequences for your wider cashflow and credit management, including the need to document, enforce, and monitor accounts payable and receivable across a wider range of counterparties.

As your firm comes into contact with larger companies bound by sustainability commitments, founders may also have to consider how they define and set governance frameworks around environmental and social data.

In our research paper "[Six ways business owners can start their net-zero supply chain transition](#)," we suggest entrepreneurs begin by measuring what matters most.

For founders scaling their firms, setting up policies that define which sustainability factors are most material to the full value chain, then committing to measurable objectives and key results *before* and *alongside* the company's growth would be worthwhile. We also believe that making early formal agreements with competitors and collaborators can help lower the administrative and financial burden of collecting sustainability data during the hectic scaling stage.

Last, founders would do well to discuss and document their strategy toward broken links in the supply chain.

Do you have a policy of divesting and finding another partner if certain operational red lines are crossed? Or would you rather develop an engagement strategy that tries to push suppliers to embrace your own commercial and societal values?

Here are two reasons we believe formalizing your supply chain practices can help you successfully scale:

- **It can give you the tools to balance continuity against efficiency.** The nature of business scaling is not linear. Fast periods of progress will often be followed by slow periods and setbacks. So, while founders undoubtedly need flexibility and an openness to learning through doing, we suggest that a formal appraisal process for your supply chain—including learning and adopting best practices operationally—can help you strike a better balance between simply producing (continuity) and producing with the least amount of wasted resources (efficiency).
- **It can make your firm more appealing to larger companies with explicit sustainability mandates.** Scaling will likely involve your firm collaborating with a growing number of partners, some of whom will be large businesses. Many bigger, listed firms face legal and regulatory obligations to vet their supply chain partners and adhere to regulations (just one example of which would be the Modern Slavery Act in the UK). Robust and comprehensive supply chain regulations reduce the due diligence and administrative burden for your prospective collaborators, increasingly the likelihood that they will be able and willing to work with you.

Next week we'll publish the final article of this three-part series. In it we shall discuss how corporate governance can help **switch** your business—whether a sale, a family transition, a buyout, or a winding down.

[1] Bourke, J. (2016) *Which Two Heads Are Better Than One? How Diverse Teams Create Breakthrough Ideas and Make Smarter Decisions*, Australian Institute of Company Directors, quoted in Bourke and Dillon (2018) *The*

diversity and inclusion revolution: Eight powerful truths, 22 January 2018, Deloitte Insights, issue 22 [online].

[2] Pichler S, Blazovich JL, Cook KA, Huston JM, Strawser WR. Do LGBT-supportive corporate policies enhance firm performance? *Human Resource Management*, 2018, 57: 263–278, <https://doi.org/10.1002/hrm.21831>, quoted in Haefele, Smiles, Wright, and Carter (2018) *Global financial markets: The commercial case for LGBT+ inclusion*, UBS Chief

Investment Office WM, 30 August 2018.

[3] Lorenzo, Voigt, Tsusaka, Krentz, and Abouzahr (2018) “How Diverse Leadership Teams Boost Innovation”, *BCG Henderson Institute* [online], 23 January 2018.

Appendix

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