The ABCs of forming an advisory board

Some CEOs and company owners don't think they need any outside advice, but most do. An advisory board can make a business leader look very smart when used effectively.

By Dennis Cagan

Today's business climate is more challenging than at any time in history. One of the byproducts of the information revolution in general, and mobile communications and the Internet in particular, is the compression of time and the ubiquity of information. There is more competition in every field, both domestically and especially internationally. There are more regulations governing every aspect of industry, and in virtually every field there are multiple facets requiring increasingly specific experience and knowledge. The granularity of issues, business models, and management specialties is overwhelming.

As the owner or CEO of any company, private or public, whether you already have a board of directors or not, an advisory board is an increasingly popular option for getting in-depth advice from a number of experts. If you do not already have a board of directors, and are not quite ready to take that step, an advisory board is a worthwhile consideration. Advisors are specifically selected for their experience and skills as categorized by their knowledge of an industry vertical, their experience in a designated management discipline, or the economic sector they are from (e.g., government or education).

The three most common varieties of advisory boards are (a) those focused on prestige, (b) those providing deep technical knowledge to augment the company's staff and provide credibility, and (c) those primarily selected to provide business development opportunities.

The determination of whether to form an advisory board (and which kind to form) is very subjective. If your firm is not required to have a board of directors, you could opt to just have advisors. If you are required to have directors, you could also add an advisory board.

An important step is to be able to clearly articulate the charter, or role, of either board. Establish clear objectives, standards, goals and tasks for the members. An important consideration is the bandwidth required of management to organize and manage the advisors. They need frequent attention to update them on company activities and solicit their contributions. Another consideration is the resources to compensate them — fees and/or equity. Also, does your company have the personnel and infrastructure to follow through on whatever advice, guidance, or introductions an advisory board member provides?

The key difference

Although the differences between advisors and directors may not always be understood by everyone, and their uses may often overlap, there are some very important differences. A board of directors, or board of managers for an LLC (limited liability corporation), is a legal requirement for most corporate structures in most states. They are usually required by the corporate charters. Their purpose is governance and the oversight of management. They are hired/elected by the shareholders or unit holders, and

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owe their fiduciary responsibility to them. They are legally empowered under the authority of the SEC and state corporate authorities, and must adhere to regulations like Sarbanes-Oxley. Over the last 10 or 20 years directors have faced increasing legal liability for their actions. These days any serious company, public or private, carries appropriate directors and officers (D&O) insurance coverage. One of the most frequent reasons given by qualified individuals for not accepting a board director position — especially on a public board — is their concern about this liability.

The advisory board is rarely privy to anything going on with the company board.

In comparison, an advisory board is never a legal requirement, but rather simply engaged to advise the company. They have no liability or legal standing. They report to management and their primary purpose is providing the company with business and technical advice, contacts and business development opportunities, and credibility-by-association. Think consultants, but usually paid less.

Board of Directors

Try for individuals with at least one characteristic from each column (selected examples only):

• CEO	• Big company/organization
• CFO	• Your industry
• Sales	• Technology
• Marketing	• Large customer/vendor/ strategic partner
• Government/ Political	• International
• Non-profit	• Manufacturing
• Academic	• Services
• Legal	

Advisory Board

Individuals with any one characteristic relating to your business is good.

- Current or past executives (not necessarily C-level)
- Past government officials
- Science – multiple relevant disciplines
- Technology – multiple relevant areas
- Notable customers
- Key vendors
- Important strategic partner(s)
- Military officers (former)
- Notable academics

Board size and meetings

The number of directors is set by corporate charter and shareholder vote. There is really no standard or limit to the size of a well-formed advisory board. I have seen boards range from one or two members up to 30. The decision becomes a matter of how many individuals you can effectively manage without wasting your time or theirs — and of compensating them. In broadly held companies shareholders will want to seat a full board of directors, but with boards of directors for closely held firms, and with most advisory boards, you may start with a lesser number and add members as deemed appropriate.

While directors must hold a minimum of meetings, advisors may never actually need to meet as a group. The corporate charter and shareholder resolutions will determine the number of board meetings. Although usually a minimum number must be held in person, telephonic or video conference calls can be acceptable for others. Most of the boards of directors I have sat on met monthly. Many of these met once each quarter in person and the others by telephone. Just as there is rarely any advisory board voting, there are often few meetings.

The individual contributor nature of advisors lends itself to management often engaging with most advisors on a one-to-one basis. With the advisors there is no overriding need to assemble en masse. But, unless you are doing it for pure show and public relations — which will wear thin quickly, especially with your advisors — you will want to actually meet. The nature of the advisory board may be such that twice a year might work; on the other hand, it could also be a monthly schedule including some in person as a group and some individually on the phone.

The most important reason for an all-advisor meeting is to be able to brainstorm on larger overarching strategic issues as a team. It can often create a great deal of intellectual leverage. This is not to say, however, that advisory board group meetings are not productive if only held once or twice a year. It's often easier to update them all on the state of the business at the same time. Also, the collective brainstorming and enthusiastic interaction of the full mix of assembled experience and perspective can be incredibly productive, especially from a strategic standpoint. It's not uncommon to make a periodic advisory board meeting a milestone event for management and key employees to prepare for and present to.

FUNCTION COMPARISON	Board of Directors	Advisory Board
Governance Responsibility	Yes	No
Legal Liability	Yes	No
Reports To	Shareholders, by annual vote	Management, usually hired under consulting agreement
Regulatory Authority	SEC, state, SOX, corporate charter	Management under authority of board of directors
General Business Advice	Yes, but structured for governance	Yes, structured only for individuals advising management in their areas of specific expertise
Typical Number of Members and Format	Workable size designed to function as a coordinated group: 3-7 (for smaller companies)	Based only on the need for advice in very well-defined domains of expertise, not necessarily in any coordinated group: 2-25
Weighted Toward	Judgment/experience/respect, fiduciary responsibilities to shareholders, higher-level issues, management considerations, internal operations, capital, and macro-trends	Meaningful strategic/tactical business advice, more detailed issues related to individual expertise such as business development, technology or industry knowledge
Meetings/Time Required	Formal format (Robert's Rules), in-person preferred but some by phone acceptable, 4-12 meetings a year, requires constant attention and regular time commitment	No standards, sometimes infrequent group meetings but usually only individually and often only by phone, 1-6 meetings a year, time varies widely but is only on-demand
Skills Focus	CEOs, financial, sales, marketing, manufacturing, academic, government, legal, prominence	Technology, science, vertical industry, big-company execs
Optics	Prestige is important, but not without substance these days; judgment, experience, credibility are key	Name recognition sometimes is main criteria, but unique deep domain knowledge should be key, with ability to help in very specific ways

Composition

In small and private companies the board of directors serves the shareholders, particularly controlling shareholders. Advisors, on the other hand, serve management, not the board or shareholders, unless they are one and the same. Their sole function is to provide management with advice and counsel — strategic and tactical, and business connections. Therefore advisors are selected for specific expertise, including deeper industry and technical knowledge, and a robust contact database. They augment management's perspective on business issues: general business, industry-specific, technical, and regulatory; and also provide deeper expertise in skills like sales, marketing, finance, legal, manufacturing, R&D, logistics, and international business. Ultimately the selection of any board member will simply boil down to the best people you can meet and convince to serve. However it can be very helpful to start off more strategically with a *wish list* of characteristics and prospects.

The most desirable characteristics vary for directors and advisors, given the differences in purpose. An advisor's main job is advice and counsel, as opposed to directors, whose main job is governance. Advisors can have overlapping skills since there is really no limit to the number you can have. There are some good arguments for seating some people of great stature on advisory boards, especially when they also possess the complementary skills and expertise that you are looking for. In fact, some very high-profile people would prefer to join as an advisor rather than a director (less liability, less pressure, less structure, less time, less ... serious).

What personalities make the best advisors? Truthfully, any. One might wonder how these two different boards might interact. Frankly, I have never seen them meet each other. Directors may be updated by management on the activities of the advisors, but the advisors rarely are privy to anything going on with the directors.

Compensation

It is unlikely that anyone of substance will serve on an advisory board without compensation. Advisory fees vary widely depending on the size of the company and the demand for the advisor's expertise. Fees can be fixed when based on a relatively fixed time commitment, or variable based on the number of meetings, calls, or assigned tasks. Compensation can be cash, equity, or a combination of both. The cash fee can be a monthly or annual retainer, or variable, perhaps per meeting. An equity component is almost always present, usually in the form of a nonqualified option grant.

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Amounts vary widely but are usually set relative to (and below) the level of equity options for senior management and the board. Although most advisors will serve for a modest annual retainer and some options, others are more expensive. For example, professional consultants in particular will not usually serve at a substantial discount from their usual fees. A reasonable general rule of thumb is to target advisor compensation at approximately one-half of the lowest compensated director. You may designate someone to lead your advisory board, which would warrant additional pay.

An incredible asset

To summarize, advisory boards are a wonderful tool to enlist the counsel of prestigious and knowledgeable individuals on a very wide variety of issues. If you can afford the time and compensation there is no real limit to the number. They can provide the best possible in-depth advice, at the lowest overall cost, about your business, markets, industry, competition, customers, sector, products, technology, and much more. Be prepared to consult with them frequently, but not necessarily collectively. At any point you wish, you can easily terminate or replace an advisor, or even the entire advisory board for that matter. Advisors and directors are both incredible assets to a company and its senior management. They can make a business leader look very smart when used effectively. ■

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