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Board of Advisers: Great Tool for Emerging Companies

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Savvy entrepreneurs know that a board of advisers can provide their company with the "four C's" that they so desperately need — credibility, contacts, counseling and cash – but they are not of equal importance.

Credibility is the key component, especially for attracting investment. While a company's product or service is critical, investors are equally concerned with a company's management. Most venture capitalists and sophisticated angel investors report that it is not just what a company has, but who they are, that matters. Good management is essential and the best way to evaluate management is by their track record. Investors prefer managers who have made money for investors in the past. However, if a company's management does not have such a track record, and given how prohibitively expensive it is to recruit suitable full-time executives, the next best thing may be to supplement current management with qualified advisers who have had successes and/or relevant experience in the market or industry.

In other words, if you cannot afford to buy the talent, rent it, by recruiting the best available board of advisers.

The company benefits from a "halo effect" from its advisers because investors surmise that if the advisers are bright, capable and accomplished, then so must be management. Moreover, if accomplished outside advisers are willing to associate with the company, the company must be worthy.

In addition to credibility, a board of advisers can provide contacts and connections that could take a young company many years to acquire on its own. They can make introductions to potential investors, customers, suppliers, joint venture partners and executives who might otherwise never return the company's calls. Advisers can provide the company with the benefit of their experience, and oftentimes, if treated properly, advisers will invest.

Recruiting Advisers

Recruiting a board of advisers requires careful thought. The company should select different advisers for different reasons and the make-up of the board of advisers should change as the company's needs change. Some advisers may be recruited primarily for their marquis value, some for their sage advice, and others, maybe, for their particular connections. Aim high with regard to talent, character and reputation and make sure to do proper due diligence on potential advisers.

Timing is important, and putting a board of advisers in place earlier in the company's development is usually better than later. For example, a company seeking to recruit a CEO will likely have more recruiting success and need to give away less of the company if well qualified advisers are already on board who can effectively assist in the CEO's recruitment.

Here's a real-life example of how a board of advisers can help. The management team of a particular franchisor of information services to small– and medium-size businesses lacked franchising experience. The company wanted to enhance the company's credibility in franchising. It therefore recruited a longtime board member and former officer of Mail Boxes Etc., and the Executive Vice President for Franchise Operations of The UPS Store, to the company's board of advisers. With such well respected franchising executives involved, would-be franchisees readily accepted the company's franchising credentials and the company soon became one of the fastest growing franchisors in its class.

The company's lawyer and accountant can often be the best connections to appropriate advisers, so it's important for the company management to connect with them on LinkedIn. The company should also look to tap suitable contacts of the management team.

Prospective advisers should be reassured that they are not officers or employees, they have no management responsibilities and they do not make decisions for the company. Therefore, companies should not need to obtain expensive directors and officers liability insurance (D&O insurance) for its advisers. However, the company should still offer in writing to defend, indemnify and hold harmless an adviser to the maximum extent permitted by law.

Members of the board of advisers should usually be recruited for no more than a one-year term with a specified termination date. This enables the company to terminate advisers without losing friends by allowing them to term off without being fired. If an adviser is particularly valuable, the company can easily extend the adviser's term for additional one-year terms or proceed on a month-to-month basis thereafter. Advisers should not be expected to make specific hours commitments. If the company needs a specific deliverable, consider a separate consulting agreement instead. Advisers should not be pressured to invest in the company. If the Company does its job, the advisers will ask if they can invest. The size of the board of advisers depends upon the company's needs and its ability to recruit. The typical range is between three and 12.

Compensating Advisers

The company should have an equity incentive plan/stock option plan in place so that it can easily issue stock options to advisers, directors, consultants and employees. The number of stock options granted to advisers varies widely, based on numerous factors, especially the adviser, but granting options to purchase .15% to .50% of outstanding shares is a ballpark guide, and may vary significantly depending on the size of the board of advisers, the caliber and expected time commitment of any one adviser and the company's business prospects. Options are customarily the only form of compensation given to advisers, although better funded companies may pay meeting fees and provide other benefits.

Options should normally vest over a two-year term with no "cliff," meaning that the adviser begins to vest immediately, and often monthly, instead of needing to be on the job for at least a year before vesting begins, as is often recommended for employees. It is fine if the adviser has not fully vested by the end of the adviser's term as this may incentivize the adviser to perform well enough to encourage the company to extend the adviser's term.

Unlike ex-employees who typically have only 30 to 90 days after termination to exercise their options, advisers often have a longer post-termination period (sometimes longer than five years) to exercise their options. Otherwise, they could be forced to choose between exercising their options by paying cash for illiquid stock and having worked for free.

Smart companies award extra options or accelerate vesting of existing options as soon as possible to reward and further incentivize advisers who perform especially effectively. For example, if an adviser assists in landing a big contract, the company may be wise to issue the adviser additional options, possibly without requiring further vesting. There is no need to compensate advisers equally and adviser compensation is usually negotiable.

Utilizing Advisers

Forming a board of advisers can be a waste of time if the company does not properly utilize it. Subject to the adviser's approval, an individual press release with a photo of each new adviser should go to relevant industry publications, community newspapers, the general media and social media, and links to resulting publicity may be put on the company's Website, and shared as a LinkedIn update. Releases should also go to an adviser's alumni publications. The adviser's biography and photo may (with the adviser's consent, of course) be tastefully featured on the company's Web site, social media sites, business plan and private placement memorandum as well.

All of this can generate favorable publicity for the company while strengthening the adviser's commitment to the company.

It helps to keep advisers informed about company developments through email and occasional calls and meetings. Some companies have quarterly or annual meetings of their full board of advisers, although it is usually better to dispense with group meetings and only consult with advisers individually as needed. Smart companies know not to waste advisers' time.

Many companies use their board of advisers as a proving ground for their board of directors. Smart corporate insiders like to see someone in action before electing the person directly to the board of directors. Directors need to be more capable these days, as the role of the board of directors has grown in importance in meeting the company's obligations to its stockholders and in recruiting, hiring and firing upper level management.

Conclusion

Experienced entrepreneurs know that the right board of advisers can enhance their company's credibility, provide it with valuable counseling, engage it with relevant contacts, leading to the cash and business that their company needs to succeed.

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