An effective advisory board, properly composed and structured, can provide non-binding but informed guidance and serve as a tremendous ally in the quest for superior corporate governance. This author, a lawyer with significant experience on boards of directors, offers a helpful blueprint for establishing an effective advisory board.

Nobody can build a great business alone, and whether it's a start up or an established industry leader, having access to high-quality advice can enhance an organization's odds of success. Entities seeking advice can obtain it from a board of directors, consultants or networks of one sort or another. Increasingly, attention is being given to advisory boards. This article discusses the role of these boards, how they should be structured and organized, and their value to an enterprise.

WHY HAVE AN ADVISORY BOARD?

Enterprises considering setting up an advisory board must answer a key question: “Why are we establishing an advisory board and what do we want out of it?” The enterprise may be seeking assistance with anything from marketing to managing human resources to influencing the direction of regulators. Thinking carefully about an advisory board’s purpose will ensure that it will be structured to maximize its contribution to an organization’s success.

Private company

For many entrepreneurs, the decision to involve outsiders in their business may be a wrenching step. Some simply do not want to dilute their control by establishing a board of directors with formal responsibilities and authority. However, the introduction of an advisory board can help some come to terms with this decision, by enabling an entrepreneur to feel comfortable with the business of providing information to, and accepting advice from, an external group.

There is a particular variation of this issue. Multinational companies may benefit (in organizational, tax or other ways) from having a local company carry on their business in a particular foreign jurisdiction. However, that same multi-national may be reluctant to cede meaningful authority to an outside group of directors of the local company. In such a case, an advisory board can address the realities of operating in a different location, with different cultural and business norms and perhaps in a different language, without any loss of control.

An advisory board can serve as a feeder group for a board of directors. The latter functions well when (among other things) it is comprised of individuals whose chemistry is good and who have the skills appropriate to the needs of the business. But the development of an effective board of directors is a long-term project. In the interim, it may be helpful to observe the nature of contributions that individuals can make, and the extent of their commitment, on an advisory board, before appointing them to a board of directors.

The smaller advisory board can, in certain cases, work more effectively than the larger board of directors. While views differ on the optimal size of a corporate board, and while different sizes are appropriate to different companies at varying stages of their lifecycles, all companies face limitations on board size. There may well be input that is required, or that is required for a defined period, that can be sought from particular individuals on an advisory board rather than allowing the board of directors to grow to an unmanageable size.

Formalizing advice

People driving enterprises often find that their jobs are lonely. For some, the issue may be that they have yet to build trust in any person or group to provide ongoing, meaningful guidance. For others, the complexity and speed of their business makes it difficult to reach out for help on any particular topic. In these and similar cases, advisory boards provide the degree of consistency, longevity and background knowledge that can allow advisory board members to know enough and have enough interest that they can advise reliably on particular issues. Having an advisory board position and receiving compensation for the position (or being committed in some other way) help to ensure that a request for assistance will be taken seriously and that thoughtful advice will be provided.

SAFE HARBOURS

Advisory boards provide safe harbours for executives who may be able to test-drive options before they are forced to be more definitive and assertive before a board of directors, which assesses the CEO and establishes his or her compensation. A CEO may feel more comfortable expressing partially defined or tentative views before a group whose sole purpose is to provide advice. For the same reason, an advisory board may also serve as an instrument of change, both as a sounding board for senior executives, and as a body that can inspire change in cases in
which comparable suggestions from the board of directors might suggest a lack of confidence in the senior management team.

Advisory boards may also be needed, as a practical matter, in certain deal structures. For instance, investors in limited partnership vehicles may require a voice in business operations, but may not wish to lose the benefits of limited liability by “participating in the management” of the business directly. Advisory boards are used frequently in cases of this sort, to bridge the gap.

Focused input

An enterprise may need advice on a particular aspect of its business (such as marketing, product direction, customer service or contact network expansion). An advisory board is created to address that particular issue only, without the need to express an interest in or to pay attention to the other aspects of the business (which a board of directors must also consider). The advisory board can focus directly and solely on the issue(s) for which it has been created, as opposed to engaging in much of the ritual that accompanies board of directors proceedings (minutes, formal approvals, ratifications, etc.).

Customer/competitor issues

An advisory board can help alleviate customer/competitor issues that may arise for a board of directors. There are sensitivities involved in being completely candid about your enterprise before a board of directors when that board also includes customers. The issue can arise in the context of the customer versus your enterprise, but it can also surface as one that is between customers if they are on the board.

Commitment

Dealing with advisory boards may be less time-consuming than dealing with boards of directors. The latter will typically meet at least four times a year, often more frequently; board committee meetings require additional time. A typical advisory board will meet only once or twice a year. Advisory board meetings can also be shorter, as the range of issues it deals with may be narrower than the range before the board of directors.

The issue of advisory board compensation is addressed further below. Suffice it to say here that this compensation will almost always be substantially lower than those required for corporate directors and than those that would be charged by comparably-skilled consultants, who would not be as consistently committed, in any event.

However, as noted below, if the desired benefit is to be obtained from an advisory board, the enterprise is well served by considering carefully the nature of the investment that must be made in terms of time, organization and cost; the commitment may well need to be substantial.

Fiduciary duty/liability issues

Advisory boards can address fiduciary duties and other liability concerns. Directors expose themselves to a variety of legislated liabilities (responsibility for unpaid wages, unpaid taxes, environmental damage, etc.) and to fiduciary and other duties that can lead to civil or regulatory liability. It is most unlikely that an advisory board member could be subject to duties of this sort. While concerns are sometimes expressed about the liabilities of advisory board members, I am unaware of any situation in which that liability has come home to roost. The legislated responsibilities apply to corporate directors only. An advisory board would have to take a much more active role in the management of a business than should ever be contemplated before there could be any realistic risk that non-statutory liability could be attached to advisory board members as such. Accordingly, qualified individuals who may not be prepared to expose themselves to director responsibilities might well be encouraged to assist enterprises as advisory board members.

Advisory boards operating around limited partnerships represent a distinctive and different case, in which liability (through the loss of limited partners’ limited liability) can be a serious risk. However, the practice of how advisory boards function in these cases is well developed, and the risk is therefore obviated there too.

Creating and operating advisory boards

In order to achieve the desired benefits, it is essential to understand who is trying to achieve what from an advisory board. A secondary question is how the business of the board should be conducted. The following issues need to be addressed.

Mandate

The enterprise and the advisory board must understand what is being sought from the advisory board and its individual members. This begins by determining just who is to be advised. The board could well be an advisor to (for instance) the CEO or Chairman, a subsidiary or division president, some other senior executive, or the board of directors generally, or it could serve as a focus group for marketing, product development, sales techniques or other aspects of the business. The nature of what is sought should determine the type of people who will comprise the advisory board and the manner in which they need to be equipped and committed to discharge their duties.

There is also the related question of what sort of advice is to be sought. Different people will be appropriate for different tasks, and the “equipment” required to perform well varies by task.

A lack of definition in either of these two aspects of the advisory board’s mandate is likely to lead to a disorganized board that will, at best, provide less value per dollar or hour invested than a well-mandated one and, at worst, will ensure a frustrating waste of time for the enterprise and the advisory board members.

Care must be taken to avoid confusion at the boundary between advisory board and board of director activities. A board of directors could feel disenfranchised when a CEO and the advisory board make a decision that is clearly in the directors’ areas of competence. An advisory board,
Occasionally, concerns about confidentiality give rise to decisions to limit the amount of information, or at least information provided in written detail. It is important to determine what the focus of the committee should be.

For instance, Algorithmics Incorporated, of which I am Chairman of the Board, is a world leader in enterprise risk software solutions. The company includes individuals who are skilled in software development, mathematics, financial engineering and risk analytics. Algorithmics determined that it would like to expand the breadth of advice beyond what its nine-member board of directors provides. It had to consider whether the advisory board proposed to achieve this should be drawn from one area of interest or across as many as all of these areas. Ultimately, the company determined that what it wanted most was the benefit of customer and potential customer input on product and market direction. The individuals most able to provide this would be executives charged with enterprise risk management responsibility. These people often competed against each other, but all would share an interest in providing suitable risk management underpinnings to their businesses. This commonality of interest might help to ensure that the group would be pleased to get together once or twice a year with the CEO of Algorithmics.

The company considered an advisory board that would also include people with skills in software development, mathematics and financial engineering. It also determined that the interests of risk managers might be different enough from the interests of others that the kind of interaction hoped for in the advisory board might not materialize. Algorithmics decided that if advice was required in any of these additional areas, it might make sense to establish other advisory boards comprised of individuals with similar interests only. While this is not the only answer to the question, it is one to address.

Focus

A board of directors has ultimate supervisory responsibility for all of the affairs of the enterprise. An advisory committee can have such a broad focus or a narrower one that focuses on a specific product feature. It is important to determine what the focus of the committee should be.

Issues of this sort also affect the manner in which advisory board members are recruited. Personal networks are quite likely to be effective here. The case for professional searchers, at least as far as that case depends on producing a board that is independent, is less compelling for an advisory board than it is for a board of directors.

Meeting organization and frequency

An advisory board is, by definition, a group. Group functioning is affected significantly by how effectively the group’s activities are organized and directed.

Advisory board members are sought out because of their personal attributes. These attributes tend to make them attractive to others, and in most cases, they are busy people. If the advisory board is to be established on the basis of meetings (as opposed to, for instance, to one-on-one consultations with the CEO), it is important to schedule meetings well in advance. I recommend that a fixed meeting schedule meeting be established on a rolling 12-(or even 18)-month basis, so that meeting dates for the next 12- (or 18)-month period forward are always known. Emergencies can arise, but the risk of conflict is reduced by establishing meeting dates well in advance.

Advisory board members tend not to be continuously involved in the affairs of the enterprise they are called upon to advise. Accordingly, in order to be effective, advisory board members must be provided with suitable information. All too frequently, meetings are held with little or nothing distributed in advance, with the result that a significant amount of meeting time is taken up in providing background information. There is probably some benefit to having the leader of the advisory board make a data-dumping presentation of this sort, but it must necessarily be of less value than obtaining the feedback of the advisors, who have been convened for the purpose of providing their advice. That advice is likely to be more useful when it can be given after reflecting on materials delivered well in advance, rather than in immediate reaction to information conveyed for the first time at a meeting.

That advice is likely to be more useful when it can be given after reflecting on materials delivered well in advance, rather than in immediate reaction to information conveyed for the first time at a meeting. An effective advisory board, providing non-binding but informed guidance, can be a tremendous ally in the quest for superior corporate governance.

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An enterprise that wants to have an effective advisory board must spend time determining the mandate of that board, recruiting members, addressing compensation issues, organizing for and orchestrating effective meetings, paying for the services of advisory board members and dealing with the other matters noted above. The commitment must come from an appropriate point in the enterprise. If the advisory board is set up well, it will assist the enterprise in avoiding important but sometimes tricky issues.

Advisory board members choose to serve an enterprise for a variety of reasons. These range from ties of personal loyalty to direct compensation. Lorus Therapeutics Inc., a company of which I was a director, had a medical and scientific advisory board for many years. The board’s mandate changed over the years, although it was never made entirely explicit. Initially, the advisory board seemed to be a resource available to management, which would discuss with its members issues ranging from the sorts of indications in which a new chemical compound might be useful to techniques for its manufacturing. One of the corporate directors was the leader of the advisory board, and he would report back in a very oblique and occasional fashion about what had been discussed. The board of directors evolved, and the advisory board has maintained the interest of advisory board members, attracting the most high profile members, obtaining independent advice or addressing issues of cost (or cash cost). There is no single formula that is right as compensation for all advisory boards: each enterprise must consider the sorts of payment mechanisms described above, and their attendant benefits and risks.

The interests of science. Lorus is a company engaged in research and development involving virulent cancers, and it has attracted the interest of advisory board members who are engaged in similar research around the world.

Members have served on the Lorus advisory board for the prestige, camaraderie and personal networking benefits that are involved.

Lorus executives have encouraged friends and close colleagues to serve on a personal favour basis.

Lorus advisory board members have been paid in cash or stock for their advisory board services.

Lorus advisory board members have served on the basis of having the costs associated with meetings (which are sometimes in interesting locations or held in conjunction with other scientific conferences) paid by the company. Sometimes Lorus has paid the costs of spouses’ attendance as well.

Lorus advisory board members have received stock options in Lorus.

Lorus advisory board members have sometimes been retained as consultants, so that they, or research establishments with which they are associated, obtain direct financial reward from Lorus’ activities.

Each of these types of “compensation” raises issues. Depending on the purpose of the advisory board, it may be important to focus on maintaining the interest of advisory board members, attracting the most high profile members, obtaining independent advice or addressing issues of cost (or cash cost). There is no single formula that is right as compensation for all advisory boards: each enterprise must consider the sorts of payment mechanisms described above, and their attendant benefits and risks.

**COMMITMENT OF MANAGEMENT/LEADERSHIP**

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up primarily to advise the CEO, the CEO’s involvement must be obvious and constant. If an advisory board is set up to assist in science or marketing, an appropriate individual, one who is willing to lend his or her name to the recruiting effort and to spend the time required to address the other issues, must be identified from that group. An advisory board that senses that there is an absence of commitment (whether by virtue of poorly organized meetings, frequently cancelled meetings, a leader who cancels his or her own attendance at the last minute, advice that is not transmitted or is ignored) will quickly become ineffective, as members will not prepare for meetings, not attend meetings or will not apply the degree of rigour required to provide their best advice.

So here we come full circle to the purpose of creating an advisory board in the first place. Advisory boards can be helpful and fulfilling, or they can be a waste of time. In the end, you get out of them what you put into their creation, development and operation.