

# SAGE HILL

Advisory & Management

## CREATING AN ADVISORY BOARD

### MEMORANDUM

To: Mr. John Q. Client  
By: Sage Hill Advisory & Management LLC  
Philip J. Toffel, CEO  
Frank M. Antalek, President  
Re: YXX Company  
Date: December 1, 2009

At this stage in your business development, an Advisory Board may be an effective management tool. In creating such a board, your enterprise would gain the advantage of having a board without the formal legal structure. As a private enterprise of numerous companies seeking growth, enhanced EBITDA, reduced risk, potential recapitalization/monetization, and other strategic initiatives, an advisory board would provide you with fresh ideas, guidance and strategic direction. If created and operated properly, such a board will challenge you to think strategically and provide a framework for sound decision-making.

### WHY AN ADVISORY BOARD

An Advisory Board differs from a Board of Directors in many ways. Traditionally, an advisory board does not hold you accountable for following through on plans. Additionally, the members do not own fiduciary responsibility. However, the board should still have a formal structure and expectations of it, in consideration of the members' compensation. The compensation, whether cash compensation or equity / incentive-based, should reflect your time and energy expectations of the members.

### CREATING AN ADVISORY BOARD

Think of the advisory board as your personal mentoring group. Populate your board with people in a variety of fields who have demonstrated success. Look for experts in banking, investment banking, franchise marketing, strategic planning, management and law. Select leading-edge thinkers with practical experience from within and outside of your industry. Even more important is to populate your board with proven problem-solvers who can absorb information quickly, have excellent communications skills and will give their own opinion or offer new ideas.

Confidentiality Agreements should always be required of all advisory board members.

### SELECTING YOUR ADVISORY BOARD

We suggest potential members have the following characteristics:

- Leadership and management experience in industry-related businesses, in businesses which are focused on driving new services through your distribution system, and in unrelated businesses yet with a clear understanding of your strategic goals.
- Commitment to the business. Board members must be interested in the business and its continued well-being. They should not be serving just for monetary interests or for personal interests.
- Time and energy to devote to board duties. Board members will be expected to spend time preparing for and attending board meetings, and to serve on additional committees.
- Integrity and lack of a conflict of interest. Board members will need to sign a conflict of interest statement and they must act in the best interest of the business, not their own individual or business interests.
- Expertise in specific areas which may not be a current focus of your management team. For example, maintaining business continuity during a change in ownership structure is important to buyers. A compensation specialist could provide input on how to retain key employees.
- Strategic focus. The Advisory Board should not be involved in operational matters. Its value to your enterprise is its fresh view from a strategic viewpoint, with occasional tactical involvement.

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## **ATTRACTING THE “RIGHT” TALENT**

After identifying the individuals you would like to attract to your board, you will need to promote the benefits to them of serving on your board. The key is to focus on how they will benefit as well as how you will benefit. After all, you want their time and expertise. In order to attract committed members, you should expect an advisory board member to want to know what he or she gets out of the business relationship.

The next step is to craft invitations that focus on the benefits you have identified. As much as possible, try to personalize your advisory board invitation by emphasizing the benefits that might appeal most to that particular individual.

Intrinsic benefits might include:

- Personal satisfaction of helping to steer a company to success
- Getting new perspectives and ideas
- Contributing to the development of a particular profession or industry
- Extending their circle of contacts and perhaps developing new business
- Discovering new potential customers or allies for your enterprise

The main external benefit is compensation and how you will compensate the prospective board member has to be part of your proposal as well.

Thinking carefully about each of the prospective advisory board members you have chosen and deciding what each one would view as the best, or most important, benefit of serving on your board will help you craft an attractive invitation. You don't need to put together a large package of materials to try and persuade someone that serving on your advisory board would be attractive to them; rather, a simple letter or call is a much better approach. Besides laying out the benefits, your advisory board invitation letter also needs to include:

- a brief overview of your enterprises
- the advisory board's mandate and focus
- the responsibility of the advisors and the time commitment expected (how often the board will meet and for how long)

State why you think the person would be a great addition to the board and what specific contribution he or she could make. You may also want to share your desire for an advisory board with “the brightest and best” with a diverse range of skills and experience. Obviously, the more experienced and knowledgeable your board members are, the better the advice your advisory board will produce. However, keep in mind that from the board members perspective, a chance to be surrounded by like talent could be motivation to serve on your board.

## **HOW MANY SHOULD BE ON YOUR BOARD?**

The number of members will vary depending upon the size and complexity of the business. A small business might have a board of three or four people; a medium-sized business may do well with five to seven; a large firm can have 10 or more members.

## **COMPENSATING YOUR BOARD**

Compensation varies widely, depending upon the vibrancy of the board and your expectations of time and energy to be devoted. Many advisory boards are simply sounding boards with only reactive responsibility; they may meet typically only via conference call. Other boards operate more like a Board of Directors with formal quarterly meetings and interim responsibilities and expectations. The compensation thus varies widely from very modest cash compensation to true incentive-based phantom equity-based compensation which vests upon a sale or recapitalization if goals are met.

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Some small-sized firms with informal boards pay each board member \$300 to \$500 per meeting; some advisory board members don't receive payments. Compensation to board members with vibrant boards typically requires thousands of dollars per meeting plus stock options / warrants and other perquisites. Stock-based compensation should be based upon the Board's participation driving the enterprise value to a new, enhanced level.

Creating dinners and other events would allow your board members to get to know one another in informal situations in which they can enjoy the relationships. Board members often benefit by networking with each other, and this can be a powerful incentive. Create a board with high-quality professionals and you won't have a problem attracting additional members.

In summary, compensation might take the form of:

- Holding meetings at a resort or other appealing venue
- Covering expenses
- Cash – an honorarium or a fee paid per meeting
- Stock options

The most common form of compensation is some combination of the above. When you're creating your advisory board and trying to persuade people to serve, don't hesitate to increase the compensation package for particular prospects. Some board members will be more valuable than others and you don't have to compensate them all the same.

We opine that you create an active Advisory Board. Set your expectations of the Board, its committees, and of each individual clearly. This will help both you and the board member with a disciplined approach and in setting expectations. As well, we advise that you share with your management team and with your team of tactical advisors the announcement of your Advisory Board. We also recommend that a priority item on the board's agenda should be to incent your key management team from a retention standpoint consistent with your goals for the enterprise, as it will be important that they feel secure as you pursue your strategic and personal goals.

## **HOW OFTEN SHOULD YOU MEET WITH YOUR BOARD?**

Quarterly meetings work well for most companies. Meeting quarterly gives you a chance to implement the ideas discussed by the board. However, you should ask for flexibility to call together the board when faced with a crisis or a unique opportunity. Serious Agendas. Board members will stay on as long as they feel that meetings have meaningful outcomes. Create an environment that allows board members to speak freely. The agenda should deal with your most important issues. Make sure you leave room for opposing points of view so that all options can be considered.

Report your progress at each meeting. Draft an advisory board charter outlining the duties and responsibilities of the board. Clearly state your desire to have board members think strategically, but allow for tactical input. While board members cannot take the place of management, if they are good members, they will relish in the part they have played in your firm's success.

## **COMMUNICATE THE NEWS**

Your company will benefit from the experience, accomplishments, connections and brain power of highly respected business leaders. Once you've gotten their permission to do so, add their names and bios to your website. Sending out a press release announcing your new board members may be beneficial, as well. Additionally, in the industry-at-large, it may be advantageous to announce the creation of your board. The background and experience of your chosen board members should announce to the industry participants whom may not be familiar with your enterprise that your enterprise and its companies are impactful, serious, well-organized, and forward-thinking. This will set the stage for future potential actions to attain your business and personal goals.