Advisory boards: what, why, who, when and how

Advisory boards have become a common way to bring in experts to advise a company's management team in a non-binding manner. By creating an advisory board, many startups and private companies are able to benefit from the knowledge of others, without the formality, expense, commitments and legal responsibilities that come with appointing a director to the board of directors or hiring an executive officer.

In this post, we will explain the what, why, who, when and how of advisory boards so you can determine if creating an advisory board is right for your company.

What is an advisory board?

An advisory board is a flexible, informal body that is created by the board of directors to provide the company's management team with non-binding strategic advice. Advisory boards can help budding companies acquire subject matter expertise, coach a CEO or management team, accelerate access to customers and channel partners by making industry-appropriate introductions that increase sales. It is possible to form advisory boards that address unique industry-specific concerns, such as scientific, medical, technical or energy issues. The idea of informality is key: the members of the advisory board do not have the authority to vote on matters brought to the board of directors and may only attend a meeting of the board of directors if they are invited. Also, the members of the advisory board are not bound by fiduciary duties and are not entitled to indemnification.

An advisory board member is different from a board observer in that a board observer is essentially a contractual right that companies grant to certain investors or individuals to attend board meetings. An advisory board is also different from a committee of the board of directors. The board of directors can form of committee, which is a subset of all the directors, to review and approve certain matters (such as compensation or audit); however, calling a committee of the board of directors an "advisory board" will not relieve the directors of their fiduciary duties.

Who should be on an advisory board?

Simply put, the advisory board should consist of experts in the company's industry. There is no one size fits all approach to finding members for an advisory board, but we recommend seeking potential members who have the following attributes: independent thought, culture fit, value congruence, wisdom, technical expertise and courage.

The efficiency of the advisory board will be influenced by its size. If you appoint enough advisors to constitute an advisory board, we generally recommend that it not exceed five to eight members.

Why should a company have an advisory board?

An advisory board enables the company to create an independent forum to test ideas, discuss strategy and receive counsel and focused input from experts. This allows a company to enhance its reputation in the marketplace, show credibility with current and potential investors, increase customer confidence and attract talent. The advisory board also has the potential to serve as a source for future members for the board of directors. Also, the advisory board can be an independent safe place to discuss the company's strategies and difficulties, helping the board of directors to think imaginatively and avoid groupthink.

In other circumstances, advisory boards are used to incentivize well-networked thought leaders in a market segment to accelerate introductions to potential customers, suppliers, vendors, channel partners or talent pool.

When should an advisory board be formed?

We generally recommend that companies implement an advisory board during the good times. It is far easier to attract advisory board members when a company is not struggling. Moreover, this gives the advisory board members plenty of time to learn about your company without having to worry about putting out a fire. Having an advisory board well in place when the good times start to turn grey may help right the ship's course.

Also, companies should consider creating an advisory board when they (i) are crossing a developmental stage border; (ii) are experiencing rapid growth; (iii) want to build strategic partnerships; (iv) need to raise funds; (v) face technical or functional problems; and/or (vi) encounter succession issues.

How should an advisory board be formed?

Advisory boards are inherently flexible, so creating them is a fairly straightforward process. First, the company's board of directors will need to pass resolutions officially adopting the advisory board. The board of directors may also adopt a charter to define the procedures, determine the nature of the mandate and set goals for the advisory board.

In addition, the company will need to have the members sign an advisory board agreement, which is essentially a consulting agreement. The key provisions of the advisory board agreement are confidentiality and invention assignment. Compensation is also always an issue. We find that a typical compensation package is comprised of options constituting anywhere from a fixed number of options to 0.25 percent to 1 percent of a company's fully diluted capitalization depending on the stage of growth and time commitment required which vests monthly. There is often single-trigger acceleration of vesting upon a change of control, given that an advisor would not typically be retained by a potential acquiror. Typically, all costs associated with the meetings are covered by the company. Further, we recommend setting a term for the advisory board members that lasts from one to three years. This strikes a balance between stability ensuring that the advisory board members are actively committed to the company and turnover that ensures regular infusions of fresh ideas.

When advisory board members are selected carefully, then the company is providing itself with the opportunity to leverage the knowledge of seasoned industry experts without the potential long-term commitments that come with appointing a director to the board or hiring an executive officer. Forming such a board is a process worth considering.
