

SEQEL PARTNERS: White Paper

AN INTRODUCTION TO ADVISORY BOARDS: Leadership and Wisdom for your Business

Introduction

The world of business has never been more challenging, more complex or more subject to change. Global surveys conducted by IBM of over 3000 Chief Executives worldwide showed the rate and scale of change to be the biggest challenge for effective leadership. What's more the IBM survey was conducted before the global market turmoil of late 2008.

The challenges of global market place, continuous growth, one off global issues and continual regulatory intervention mean that Business Owners confront ever more challenging and conflicting issues. The challenge of business entrepreneurship is to identify the issues the issues and to turn them into opportunities.

All business is founded on the principle that a collaborative group of capable people can achieve more than any one individual. It is the effective combination of people and process that provides for the success of business in our society. Having seized the initiative, created the vision, and embarked on a mission, the level of effectiveness of any enterprise will be determined by many factors. Of those *leadership effectiveness* will be the most important. For Business Owners leadership is a very complex issue. We

call this the 'Business Owners Dilemma'. At any one time a business owner has many hats -

- > **Shareholder** - Founder of the business
- > **Director** - Stewardship of the shareholders' capital, often representing more than one shareholder - Such as other owners, family members, investor trusts
- > **Leadership** - Delivery of vision, inspiration and hope to the enterprise
- > **Management** - The effective implementation of systems so that processes provide an effective, productive organisation
- > **Doing** - For many - Completing many of the functional tasks of operating the business

For many business owners this dilemma is compounded by that fact that they are often situational entrepreneurs. They have attained skill in a particular sector of the economy or identified a particular market niche in which they have created and expanded a business. The business has over time grown because of the all round skill set of the entrepreneur in attracting and managing work. However, there are many risks with this type of business and this type of business owner.

Firstly, there is the leadership expression that 'What got you there, won't keep you there'. Business owners who continue to do the same things will continue to have the same problems - and ultimately will find their business cannot achieve growth, are owner dependent and decline in performance and value.

The challenge for business owners is to move from:

- > **Owner Operator** - Where the business owner makes all of the decisions; to
- > **Owner Manager** - Where the business owner engages management teams with capability in disciplines in which the owner often requires more skill as the business grows. These usually include finance, sales and marketing, and operations; to
- > **Founder Entrepreneur** - Where the founder of the business migrates to a leadership position where the business is effectively managed on a day to day basis by the management team, but the founder's stewardship is required for vision, strategy and direction.

These types of transition create increasing levels of conflict for the Business Owners' Dilemma - the 'Conflict of Hats'. Business owners need to achieve a separation of their roles and continuously define and refine the best way to lead their business into the future. And it is difficult to achieve. A large survey in Australia of 100 business owners over eight years found only 10% achieved Founder Entrepreneur status. In short the rest couldn't let go of the reins.

Smart Business Owners will realise that they cannot be all things to all people. In many businesses, the fact of the 'situational entrepreneurship' of the founder means that the owner has issues, including:

- > **Leadership** - Effective founder entrepreneurs need to understand the distinction between leadership and management. Like all things this

often takes the rigour of self reflection to be effectively achieved.

- > **'Don't know what they don't know'**
 - As the business increases in scale, issues such as finance, technology, supply chain, marketing and systems thinking become complex, and often beyond the capability of the existing founder.

To address these issues smart business owners will accept the need to seek guidance from people who have more substantial experience. Experienced wise people who have worked in large scale organisations understand what good looks like, have had (many) good and bad business experiences, and they understand the challenges of effective leadership - the need for self reflection and personal growth.

Business entrepreneurs who wish to achieve continued and sustainable success for their enterprise should seek the guidance, leadership contribution, strategic thinking and experience that capable Advisory Board members will bring. Does this work? - Absolutely. A substantial review conducted by leading consulting firm McKinsey in the United States showed that businesses with truly Independent Directors had long term performance of 16% per annum over and above those that lacked true independent thought at the leadership table. (4)

So What Is An Advisory Board?

An Advisory Board is a board which is established to help the Business Owner to more effectively lead and manage the enterprise.

It usually includes:

- > The Business Owner(s)

- > One or preferably two independent, carefully selected people who can help guide the business. These people are usually highly capable, professional, independent directors who bring strategic and fresh thinking, experience and wisdom to the Advisory Board.
- > Management Team - Commonly, a General Manager, usually the Finance Manager, and by invitation, other key leaders/Managers within the business might also be included within that Advisory Board (either formally or by invitation).

The purpose of these Advisory Boards is as follows:

- > Strategy / Business Purpose - To assist in the clarification of purpose, delivery of direction and the provision of focus to the Owner, the enterprise and the key leaders and managers.
- > Stewardship - Assist the Business Owner to assess and manage performance, risk and compliance.
- > Intervention - The capability to intervene in the business to assist both the owner and the executive to resolve issues, and provide guidance about effective processes for people, leadership and process management.
- > Networks - Effective Directors will significantly expand the business owner's access to competent, high level networks of professional people, independent business colleagues, influencers, and others with specialist skill that can assist the business achieve higher levels of performance.

What Structure Should Be Adopted

An Advisory Board is established on the same or similar terms to a proper Board of Directors, but is not the legally

authorised Board. For that reason, some differences (noted below) should be made clear by the manner in which the Advisory Board is set up. The Advisory Board should include:

- > Ideally an independent Chairman - preferably not the Business Owner
- > One or preferably two other truly independent Advisory Board Members who bring skills and experience that significantly supplement that of the existing Business Owner and the management team of the enterprise.
- > The Business Owner
- > The Chief Executive / General Manager, Finance Manager
- > Possibly other key management

Establishment Principles

The Board should establish terms of reference, objectives, purpose and activities. An Advisory Board should be established by way of a clear and unequivocal agreement in writing by the company's Board of Directors which would normally include details of:

- > The Advisory Board's composition
- > Appointment Process
- > Tenure of appointment of its members
- > The terms of reference including its Objectives, Purpose and Activities
- > The regularity and nature of Meetings
- > Type of Reports to be presented
- > The basis for decisions
- > Confidentiality Agreements
- > Any area specifically excluded from its Overview
- > The mechanism for reporting back including the identity of the recipient (for example, the Board of Directors or Business Owner and Management), style of communication and

frequency. Reporting should include Advisory Board Minutes, and ongoing Project Plans.

- > Remuneration arrangements
- > Directors' and Officers' liability insurance
- > Procedures for dealing with Conflicts of Interest

It should also be made clear that the Advisory Board has no delegated authorities, cannot pass resolutions on behalf of the Company, and does not constitute a subcommittee of the board of directors, and that it is independent of the company.

Authority

Non binding arrangements - It should be clear that the Advisory Board is not able to make binding arrangements for the Company, and that the formal decision process remains with the actual appointed Directors of the Company who in all respects maintain effective legal control of the enterprise. This serves two purposes:

- > The Advisory Board members may in this way potentially not be liable under the Companies Act as 'Officers of the Company' (they should nevertheless be insured under the Company's Directors and Officers Insurance policy); and
- > The Business Owners who are the Companies Act appointed Directors need to ratify all legal Board decisions which require formal board approval.

How Do You Establish Such A Board?

The best practice is to use an Executive Search firm that specialises in appointments of this nature. They will be capable of working with Business Owners

to identify their strengths and weaknesses, and the fit and capability which is required to achieve success.

What About My Lawyer or Accountant?

All Business Owners need the close support advice of a competent lawyer and an actively engaged accountant. They can sometimes assist in finding capable, independent Advisory Board members. However they are mostly too close to the business, and potentially conflicted in business decisions to be appointees. It is often a good idea to retain the lawyer and/or accountant as an advisor to a Shareholder Committee which deals with the Business Owner (and often family members).

Shareholder Committees

Shareholder committees should be established and meet usually on a six monthly or annual basis to provide guidance to the Advisory Board about the key ongoing objectives from the shareholder / family perspective. The Shareholder Committee should provide clear guidance to an Advisory Board about their objectives in the short, medium and long term. This includes:

- > Objectives for the business; and
- > Objectives, requirements or needs which must be met for particular family members in terms of their involvement in the enterprise; and
- > Expected revenues, appetite for risk, attitude to growth, acquisition, debt etc.

Who To Look For?

In appointing independent members of an Advisory Board, you should be looking for people with the following attributes:

- > Relevant experience
- > Complementary skills in markets, sectors and businesses which are relevant to the enterprise
- > People who have a strong track record of leadership roles - usually Chief Executive or Managing Director - in a successful company much larger than your company/ For some specialist skills e.g. Finance, Technology, Marketing, very senior executive management roles will be sufficient.
- > Capable, experienced people with good independent view and a positive commitment to contribute and challenge, but a collaborative style

Meetings

The regularity and nature of meetings should be established. It is generally a good principle to set up monthly meetings for ten months of the year in advance. In this way Independent Advisory Board members can ensure availability.

Risks

There are always risks to any arrangement involving the governance of an enterprise. However the best way to minimise risk is to:

- > **Independence** - Have capable, independent governance providing the best possible stewardship of the enterprise;
- > **Leadership** - Provide capable and inspired leadership that gives hope to the enterprise, and provides effective management.
- > **Risks** - Adopt reporting policies and procedures which effectively manage risk in your enterprise by including effective compliance arrangements in

all reporting systems - particularly for Health & Safety, Solvency and other key business risks.

Costs

Business owners need to see the appointment of an Advisory Board member as an investment in development, both from a personal perspective, and for business performance. A highly capable and experienced Board member might cost between \$30,000 and \$50,000 per annum, and between 50% and 100% of that again for a very capable, independent Chairman in a larger company. While these costs appear substantial for attendance at 10 - 12 Board meetings and a weekly level of engagement, people of this calibre always deliver value well beyond this cost. The independence of thought, the consideration of unintended consequences of decisions, the ability to influence decisions, provide networks within markets, and provide strategic direction should always mean that an Advisory Board member delivers many multiples of value to the business in excess of the cost of engagement.

Frequently Asked Questions

- > **Hiring and firing my Advisory Board** - All Advisory Boards are usually appointments 'at will'. That is the Appointee is on a monthly retainer, and the arrangement is a commercial contract for services which can be terminated at will. However, the best types of commitment are to get people engaged for an annual renewable arrangement so that there is commitment by both parties to the arrangement. An annual review after the end of each Financial Year is a

good way to determine continuing contribution and relevance.

- > **Costs** - What does this all cost? A highly capable, truly independent Director will cost a company between a minimum of \$24,000 and a likely maximum of say \$48,000 per annum. For a Chairman's role you would expect to pay more - up to double that amount.
- > **Can I get it cheaper?** - Yes, you can sometimes get a capable person to join the business on the basis of quarterly reviews. This might reduce the cost to between \$10,000 and \$15,000 per annum.
- > **What can go wrong?** - The most common issues for Advisory Board appointments is potential 'lack of fit'. That is, despite the first impressions, the independent Advisory Board Director cannot get along with the Business Owner. The other possibility is a substantial difference of opinion about either strategic or operational direction of the business, or decision making processes. If these things arise, they should be dealt with openly, and if matters cannot be resolved, it is best for the Advisory Board appointee to resign.
- > **Liabilities** - If an Advisory Board arrangement is properly established, there is an argument that the Advisory Board appointee may not be treated as a Director or 'officer of the company'. However this should not be relied upon. Advisory Board members should behave as if they were Directors and be insured as potential 'Officers of the Company'.
- > **Should we keep separate minutes?** - Yes. Separate minutes should be kept for Advisory Board meetings and

statutory Directors meetings of the company where resolutions are required for financing, Companies Act, audit or other regulatory requirements.

- > **How do I find these people?** - The best source of potential appointees for truly independent Advisory Board is to use a senior level Executive Search firm. These capable practitioners have extensive lists of people with relevant experience who are willing to take on Advisory Board positions.
- > **Due diligence** - How much should I tell an incoming Advisory Board member? - The best arrangement is to obtain a Confidentiality Agreement and to fully disclose information to the intending Advisory Board member. Full disclosure with 'no surprises' is the only way in which a long term relationship of trust can be established.

Meetings and Reports

Advisory Board Meetings

- > **Regularity** - The recommendation is that Advisory Boards pre plan to have 10 - 12 meetings per year. If you are intending to attract top flight Advisory Board Directors to your business, then having meetings in the earlier part of the month will increase their likely availability. Larger companies tend to have Board meetings in the latter part of each month to enable full financial information to be available.
- > **Agendas** - Agendas should always be prepared by the Chairman of the Advisory Board in conjunction with the Managing Director / Business Owner / General Manager.

- > **Reporting Systems and Content** - Most effective businesses establish 'dashboards' or key performance indicators 'KPIs' which are continuously available to all the senior people in the business. This information forms the basis of the financial reporting of the business. Operational reporting is best provided by the operational line managers in reports which deal with variances to projected performance.
- > **Business Projects** - All businesses will have ongoing projects. Project plans for each sector of the business, with monthly upgrades, accountabilities and performance to plan provide a convenient tool for an Advisory Board to assess the ongoing performance of management.
- > **Strategic Reviews** - The very best Advisory Boards will engage an independent strategic facilitator to conduct a strategic review of the business on an annual basis. This would usually be a one day exercise involving the Advisory Board, the executive team, and the facilitator. It will usually involve a PESTE and SWOT analysis to give the Advisory Board and Executive an opportunity to refresh the direction of the business. Business plans, project plans and operational plans can follow from this review.
- > **Board Reviews** - It is good policy, recommended by the Institute of Directors that just like formal Boards, an Advisory Board conducts an annual review of its performance in a full and frank environment to ensure that there is ongoing contribution, particularly from the independent Advisory Board members. A facilitator

can often add value to this review process.

- > **Shareholder / Family Reporting** - Many private companies are owned by Trusts or combinations of the owner and relevant family members. Frequently, both the owner and family members are also engaged in the business in some capacity. The establishment of a Shareholder Committee involving core family members, and Trustees or close personal Advisors - usually the lawyer and/or accountant of the Business Owner, can be a very important feature of continued success for family owned enterprises. These Committees might meet one or two times per year to discuss their requirements as close family members and shareholders. These wishes are then best conveyed to the Advisory Board - to ensure that the Advisory Board which is helping the Business Owner with stewardship of the Company works in the best interests of the Company, and the founder family members and other relevant trustee shareholders.

Contact:

Don Jaine don.jaine@seqelpartners.com

09 3587407

Mark Ashcroft

mark.ashcroft@seqelpartners.com

09 3587408

About SEQEL Partners

SEQEL is a specialist Executive Search and Advisory practice which facilitates the appointment of Senior Executives, Boards and Advisory Boards in the New Zealand corporate and privately owned business market. To find out more about SEQEL please visit www.seqelpartners.com