Management Methods Manual

Bulletin

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File: Corporate Planning

# Corporate Structure: Using Outside Advisors/Directors

**Foreword**

This Bulletin is for general information purposes only. Before adding outside directors or forming an advisory committee, you should consult with legal counsel.

This bulletin deals with two aspects of expanding the management resources of a privately-held company by bringing in outsiders—what can they do for you and how should they be brought in?

Outside advisors can help the company in many ways: they can provide independent standards for management's performance, answer specific questions on operations, force management to plan for the future of the business (including succession), arbitrate internal differences, and keep management alert to relevant changes in the external world.

People who serve as outside advisors should (1) be objective and disinterested—have nothing to gain personally from the knowledge they will pick up about your company; (2) have experience in somewhat larger, successful companies—you will want help in handling changing problems as you grow; and you are interested in learning how to make money, not how to go broke; (3) come from backgrounds or businesses different from yours. Since no outsider can know as much about your business as you do, you need people who will challenge traditional ways of doing things and help establish the individuality of your firm; (4) be sensitive to the coaching, appraising function and be both sufficiently patient and firm so that they can guide, counsel, and teach without resentment.

You have a choice as to the form of a group of outside advisors: they can be actual members of the board of directors or members of an advisory committee. The board is elected by the stockholders and appoints the officers. In situations where management and stockholders are the same, it is rare to find a board not dominated by stockholders or their families, and therefore not truly independent. The board is legally responsible for the overall conduct of the company which it delegates to the officers. The advisory committee is entirely a creature of management—it has no legal status, appoints no one, and exists exclusively to help internal management.

Compensation for both should be about equal, since the same service is expected from people of the same caliber. Payment for each meeting attended runs from $300 up. An added inducement is to hold a meeting at a resort area once annually. Aside from the equity of paying busy people for their time, a fee makes the relationship professional and easier to sever if someone is incompatible or incompetent. Assuming three outsiders at $300 a meeting, four meetings a year, your annual net after tax cost would be about $2,000 including some expenses. (Add the time of management to prepare for the meetings.) It would be hard to find a $2,000 expense which has the potential to make such dramatic improvements in a company.

Where do you find people who will serve on the board of directors or advisory committee of a small company? We must now compare the two forms because the personal liability to which members of a board of directors are exposed is a deterrent strong enough to eliminate many good people. The inducement of stock options or a chance for a direct investment in the company may attract some potential directors, but this may be a high price for the current stockholders to pay for outside help, and the individuals would no longer, in fact, be outsiders. The advisory committee has been successful as a device to involve capable people precisely because it avoids the liability problem.

Aim high when you look for advisory committee members. People who have been successful advisors include the head of a grocery cooperative, the retired vice president of a retail chain, the president of a $40,000,000 chemical company, the financial vice president of a real estate company, a top officer of an insurance company's commercial loan department, partners in an accounting firm and a general contractor. Good people will serve because your invitation flatters them and the experience of helping a company grow is satisfying and fun.

Also aim high for the subjects you want to cover: the type of business you want to be 3–5 years from now; personnel, space, financial, technical, equipment needs; ways of determining whether top management is doing a good job; what is likely to happen in the world that will affect you?

A few mechanics: hold the meetings during the day (it not only dignifies them but people are more alert); be sure to have an agenda distributed in advance with as much background data as possible; run the meetings tightly (for example, start at noon, stop at 3:00 p.m.); send out minutes promptly showing who is to do what by when; schedule the meetings at least once a quarter, perhaps monthly to start; tell the members that you are experimenting with the idea and with them individually; try to have more outside than inside members; a committee of five to seven people works best.

Before establishing an advisory committee or adding outsiders to the board of directors, clarify your objectives in running your company and test your willingness to submit to outside advice. If you decide to use outsiders you will find that an advisory committee (or having outsiders on the board) can work wonders in focusing management's energies on significant survival and profit problems and opportunities. It is a tough discipline for management—the questions asked may be embarrassingly gutsy. But, outsiders can and should ask tough questions, and then help you frame the answers.