ATLAS ACCELERATOR

Building Your Board

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Building your board is one of the few proactive steps you can take to build valuation that doesn't necessarily directly involve your product or service (unlike sales or product development). Investors will recognize your appreciation of oversight and will be influenced by these directors spending their valuable time for stock-based compensation.

Advisors vs Directors

Most entrepreneurs are keen to build out advisory boards, signing members on an opportunistic basis only. While there is a place for adding advisors who, from time to time, become known to you and sound valuable, that's no way to build your advisory board.

Step back from the madness of big names and well-connected people and come up with a plan. What would your ideal advisory board look like? Every business is different here, but, good advisory boards generally include people with various industry connections for help with revenue generation and/or deep product knowledge. For example, one of our portfolio companies, DigitalScirocco, runs an on-line auction for content. The CEO brought in Michael Wellman who is arguably the top researcher in computational market mechanisms for e-commerce to architect their platform.

The expectations for advisors versus directors are lighter; less contact time and no fiduciary duty. It's not unusual to have zero contact with an advisor for months. This isn't the case with your directors and it's one of the potential flaws with building an advisory board.

Many entrepreneurs add advisors each time they see an interesting name. Typically, that person helps with a key introduction or an immediate issue and then fades away, but their compensation continues. If you have an advisory board, commit that you'll look at it quarterly and determine if each person is still earning their compensation. Don't be afraid to terminate someone who's no longer involved.

Your directors, on the other hand, are responsible for your strategic direction and have numerous specific responsibilities as well. These likely include determining executive compensation, approval of the budget, approval of funding rounds and, of course, approving any M&A. They have a fiduciary responsibility to all the shareholders to ensure that the company's activities are in the best interest of all the shareholders.

Composition

A manageable advisory board is under ten members. There's no minimum as many companies do quite well without one. If you sell into markets that are quite different (for example, Digital Map Products an Atlas company, sells to local government, search engines, and land developers), you might find that getting some representation from each of these industries help you position your offering in each segment.

You may also find you want an advisory board of customers (the Customer Advisory Board), which is a great way to keep you engaged with what your market needs and validate your product roadmap (as well as sell more to your existing customers). Again, under ten people should be manageable. This group does not typically comingle with your regular advisory board.

Your board of directors will probably consist of 3-5 people. We always state that the board will contain *up to* five members to allow you time to recruit. That's usually the CEO, one rep for the common, one for preferred, and two outsiders.

Think strategically about your board. You need someone with connections to money, a technology or product expert, and someone who knows your customer or market. One or more of these people probably know enough about corporate governance (and your lawyer will help as well). I say this because too often I see boards filled by investors who know corporate governance and nothing more. Frankly, that's the easy part. Helping you take a product or service to market (and not just because someone's smart – but because they know *this* market or *this* product) is much more valuable.

Investors will ask for several board seats and you may feel that you need to comply. Often, you'll do what's needed for the money but know this: people who buy their board seats will often be your weakest directors. There are many exceptions to this and I've worked with some great directors who were venture capitalists or super angels. Overall, however, people with big checkbooks often lack enough practical experience to do more harm than good. The typical, unfortunate, case is the venture partner who either had one big hit or who came up through finance or banking to become a VC. Large investors may ask for several board seats, but in the negotiation to limit that to one and fill the other seats with people who can really help. People who never owned a P&L, brought a product to market, or have other operating expertise are dangerous to you and your board. Being smart, good-looking, and well-educated works to assess investments but doesn't work in running a company.

Compensation

Until recently, I've never seen cash compensation for a start-up board or someone on the board of advisors. Well, the rule's been broken but only once so I can still say that compensation is stock only.

The amount of stock varies by the maturity of the business. Typically, you can expect to give your advisors about 1/10th to ½ of a percent, typically vested over 36 or so months. There is no cliff because you may part ways after only a few months and it wouldn't be right to leave them with nothing. Directors can expect about ½ to 2% vested over that same time. There are exceptions for highly involved directors. Also, we've occasionally given commissions to advisors who bring in deals.

Activities

You should get your advisors together about annually in person, maybe once again or so over the phone. You generally won't get anything directly out of these meetings but it's a good way to keep them current and it's healthy for them to meet each other. Otherwise, your activity with advisors is typically one-on-one and as needed by you. In rare occasions (this is how I provide my advisory work), you may

have an advisor you meet regularly but that would make sense only if there's a broad relationship over many areas.

Your advisors are typically there to open doors for you and to explain how an industry works. They should lend credibility to your business because of their position within their industry. They expect you'll use that credibility and you can talk with them about how to make best use of them as well as their reputation. Advisors can also be used to mentor new executives on your team who may be in an executive role for the first time.

Your directors will meet between monthly to quarterly in person with additional meetings based on events like financings or large transactions. You should take advantage of these meetings to bring in others from the team for occasional reporting. Many CEOs spend very little time with any directors outside of these meetings. While that's not necessarily problematic, you should be sure that you're forming a close relationship with at least one director. When management is excused from the board meeting (yes, Mr. FounderCEO, that's you), the company will benefit by having one person in the room with deep knowledge of internal issues.

Time Commitment

Advisors should expect to attend a half-day meeting annually and then help out about an hour or so, on average, monthly. There can certainly be dark periods followed by periods of heightened activity.

Director meetings typically last a half-day and are often (should be) preceded by dinner to help the board get to know one another. Additionally, directors get involved in reading the company's financial and other reports in advance and will engage in helping you with issues like writing a term sheet or reviewing a contract. Overall, directors spend about 2-10 hours a month with the company.

Are They Adding Value?

Every now and then (at least annually), step back and assess your board. Sure, they're at the meetings and they don't say anything stupid, but are they adding value? Make a list of times each director initiated a program that added value. Make a list of times each director took an unpopular stance the proved to be helpful.

Most directors will avoid giving the appearance that they're not smart enough or don't know enough about the business. Most will not take risks in the board room. Worse than that, many will spend time telling you to sell more or explore programs that you know you cannot afford.

There are some wonderful directors who will have the courage to be wrong in the board room and who will make a difference that you can point to. Those are the keepers. The rest (most) who go along with the flow aren't really helping you. You may not be in a position to act on these but you should at least be aware.

D&O Insurance

Most early-stage companies don't buy this costly insurance. But outside directors will often require it. We usually see the purchase delayed until the company is shipping product.

D&O is needed because directors (and officers) can be personally liable (or at least sued) for issues from sexual harassment to defective products. In general, a personal umbrella policy won't cover someone's work as a corporate director.

With or without D&O insurance, sign a mutual indemnification agreement. Your attorney has a standard one. This agreement will state that no director will sue the company or another director and that the company agrees to stand in front of any director who is sued (by anyone – shareholder, customer, employee). This is an effective prophylactic against many shareholder suits because they can't damage the directors without harming their investment. Note that no insurance or indemnification will protect a director who committed fraud or was grossly negligent.

Also, if you get D&O, be sure to cover employment practices. This is often optional and overlooked but the most likely cause of a suit will be related to an employment issue such as wrongful termination or harassment.