Building a better working world

Establishing and evolving your board

Practical guidance and considerations for entrepreneurs, private companies and family business owners

> For early-stage and fast-growth companies, the right board at the right time can make the difference between growing successfully and failing to scale.

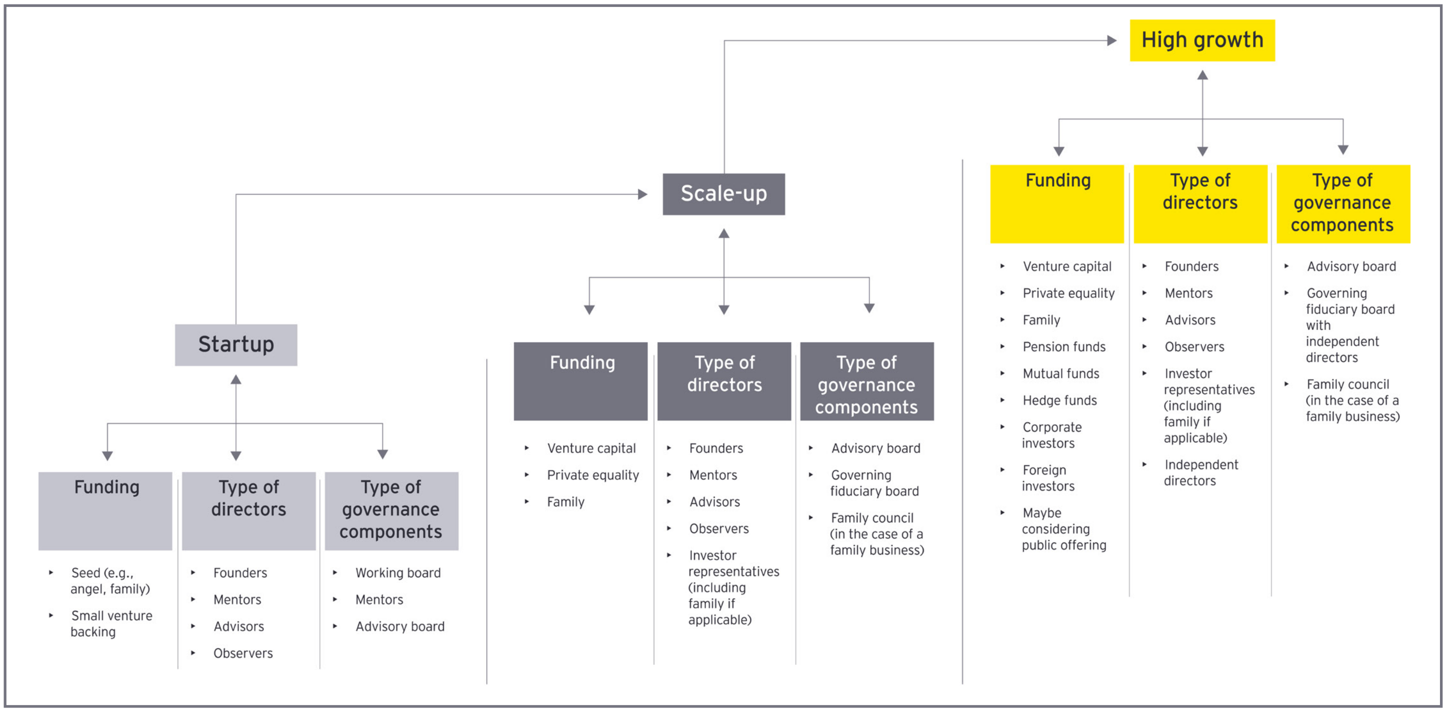
How boards can help companies grow

For the ambitious leader of a scrappy young company full of entrepreneurial energy or an enduring private business seeing breakout growth, a board can seem like a burden or a future need, something necessary for public companies, but nothing immediately valuable.

Stop for a moment and ask yourself where you want your company to be in five years. Is the answer greater commercial success? Global market dominance? Acquired in a successful transaction or on the way to an initial public offering (IPO)?

Whatever your answer, be honest with yourself: Do you and your executive team have the right experience, contacts and skills to reach that goal on your own? Most founders will say they do not. A board can provide a business access to seasoned C-suite leaders and other experienced hands to offer the guidance, wisdom, skills and contacts you need to achieve your objectives and beyond. And when thinking about skill acquisition, a board can be a logical step even for a small private company.

The type of board and composition of board members you need will change depending on your company's lifecycle and funding stage.



An advisory board offers young companies:

- Guidance from seasoned executives
- Specific skills or knowledge to fill capability gaps
- Access to valuable networks, including potential investors
- Different viewpoints and perspectives that help guide day-to-day business operations
- Credibility by association

Startup/early-stage company — advisory board

A startup or early-stage company is usually focused on building a foundation for the business concept and a customer base that can support the product or service. For this stage, an advisory board with directors who take more of a mentorship role can provide strategic guidance, act as a sounding board and introduce company leaders to business and industry contacts.

An advisory board is a committee, usually around three to five people selected by leadership, that helps the company accomplish certain strategic objectives. Unlike a fiduciary board, an advisory board doesn't have the authority to make or enforce decisions; rather, it suggests and offers guidance aligned to the objectives set forth by the CEO. It's less formal and usually made up of other founders, business mentors and advisors to the company.

This type of board is perfect for the fast-and-furious startup stage when you and your team may not have the time or the right people to keep an eye on focusing on the future direction while you focus on flying the plane. It can also be helpful to long-standing private companies pursuing a step change in their growth ambitions or considering major business model changes.

Advisory board directors are usually unpaid at the startup stage, though you should still have formalized agreements to define expectations, including board member responsibilities; compensation, if any, which most often takes the shape of payment for future success; frequency of engagement and duration of service.

How to choose an advisory board director

In the startup stage, the board has three vital roles to play: advising the CEO/founder, bringing critical skills to the company and providing access to their network.

So, start your search by asking yourself two questions: What experiences and skills do I need that my management team lacks? And in what areas of the business could the board add the most value?

Keep in mind that you want to assemble a board with the people you need — not the people you already know, or family members who may already function as informal advisors. You need new perspectives, new ideas, seasoned leaders who will challenge you constructively and who will help embed your ideas with objectivity and discipline.

You want directors who bring the experience you and your team might not have (e.g., industry knowledge, company growth expertise, operational experience in critical areas, key contacts). An ideal director has the experience to weigh in at crucial points in the company's growth, can provide advice when bumps in the road happen and knows how to manage through them.

> You also want to prioritize diversity — in all the ways diversity is defined: experience, race, gender, ethnicity, cognitive skills, backgrounds, past roles, etc.

It is proven that high-performing companies are supported by diverse boards — and this will be true as your business evolves from the startup stage to scale-up to high-growth and through transformation into a public entity, should you take your company in that direction.

Potential investors will be looking at whom you can attract to your board. Strike a balance between those with the vision and personal brand to excite investors and customers, and those who have the time to take on the job.

Board members should also be a source of contacts for potential customers and vendors. For instance, if you are looking to get your product onto store shelves, a director with connections in the retail sector can help broker the right conversations.

Don't neglect overall board composition. You want your board to have the right kind of camaraderie — where people get along but are also willing to speak their minds.

Scale-up/high growth — advisory or early corporate board

As you begin to scale and attract more customers and investment — perhaps eyeing an eventual IPO — it may be time to consider a corporate board with formal duties and oversight. If you form a C corporation or an S corporation, a corporate board is a requirement.

During the scale-up stage, the company is growing from a single product line or market to a diversified product mix and/or geography. It likely needs to secure more funding and as such needs to demonstrate stronger operational and financial rigor to meet the expectations of venture capital or private equity investors. This is also the time to shift board attention to focus equally on risk management, compliance, and longer- term value generation, not just short-term growth.

If the company is considering an IPO or a sale, effective board governance can help demonstrate the needed credibility and rigor of professional financial statements and oversight it takes to go public.

Operating an effective board

Boards of all types and in all stages run best with preparation and open communication between board members and with management. The following tips can help board members operate as a team smoothly:

- Embed purpose into the business strategy so that intention and execution align.
- Make sure board members know each other and why they have chosen to join this particular board.
- Plan for each meeting well in advance; circulate a proposed agenda with concise topic summaries.

Tips for finding and evaluating board directors:

- Explore your own supply chain, both downstream and upstream. Your suppliers are often successful, well-run companies, and directors from those companies will have a clear understanding of your industry.
- Contact executive search firms.
- Look beyond the resume for someone who has a clear belief in the company's vision and purpose.
- Prioritize diversity in skill sets, experience, knowledge and points of view, as well as gender, race and ethnicity for a stronger and more effective board.
- Consider recently retired CEOs of other successful companies or retired partners of professional services firms.

- Have all board members review the information/materials beforehand and give input on the proposed meeting agenda.
- Address the necessary, short-term priorities during meetings but leave enough time for open discussion of topics that will be strategically important in the longer term.
- Use technologies such as AI to assess financial reporting and other areas that involve routine tasks; doing so will open up time for discussion and decision-making.
- Resolve all board conflicts verbally and during the meetings, not through email.
- Hold two closed sessions during the last half-hour of each meeting: one with the CEO only, then another for board members only to resolve outstanding issues.
- At the end of each meeting, have the lead director recap what they will tell the CEO post-meeting. That director would then speak with the CEO privately.
- Embrace diversity of thought and other differences by regularly seeking a wider range of internal perspectives and consulting with external subject-matter experts where appropriate.

Evaluating potential high-growth board directors

As you move through the scale-up stage, even if you are not planning to go public, your investors will typically take a seat on the board as part of the financing arrangement, so you should evaluate them carefully.

Consider potential investors for the knowledge and experience they offer the company. Look for people who will be constructive at the director level and a good fit with your values and who will enhance your brand, along with filling specific knowledge or skill gaps.

This is the time to start considering the addition of committees (like Compensation, Nomination, Governance and especially Audit) that will be critical as you move to the next phase. Also consider bringing on more independent directors (those who have no material relationship to the company, aren't part of management and aren't involved in daily operations) who can play key roles, especially committee chair roles. This is also the time to begin compensating your advisory board members, usually in the form of equity.

Transitioning to a public governing board

You may decide to prepare for an IPO: that doesn't mean it's time to sack your advisory board. Indeed, the existing board can help you set the stage for the move to a formal public company board, and existing board members may transition well to the fiduciary board.

It may be time to formally move out directors who have served you well but don't have the depth and knowledge to take your company to its next stage. You can start by moving to a more formalized committee structure. Each committee should have a formal meeting cadence, a charter and a set of responsibilities that is well understood by every board member

At this point, the remaining early-stage investors may choose to leave the board, opening seats for independent third-party directors, including those required by Securities and Exchange Commission regulations.

Your main priority should be the qualifications of the board members. Public company board members must provide the insight, oversight and foresight to help with audit, compliance and risk management matters, as well as long-term value and the maintenance of investor and stakeholder relationships.

Work with your advisory board to envision your dream board and identify qualified candidates, keeping diversity and board dynamics firmly in mind.

Statutory requirements will help you focus your search. Each public company board must have a majority of independent members. The audit committee must be composed of at least three independent members, one of whom must be an SEC-verified "financial expert."

Also, new SEC rules will require evidence of cyber and ESG skill sets on the board, so ensure you are current on pending SEC disclosure requirements for director skill sets. Your board should feature operating experience in the company's functional areas. The directors should have a record of service on public company boards as well as the right kind of connections to take the company to its next stage of growth.

At this stage, the dynamics of the board become even more important. A board that can't find consensus is less likely to provide useful advice and guidance. If board members don't get along, that's a matter of public record and does not reflect well on the business — or on you as its CEO/founder.

Going public — governing fiduciary board with independent directors of giants

If you intend to go public, you should begin preparing up to 24 months before the IPO. A fiduciary board member's primary job is to serve the shareholders, act as a trustee of the company's assets and take steps to make sure the company is well-managed and financially sound.

A public company board has specific authority, including:

- Exercising fiduciary duties in the best interest of the company and its shareholders
- Overseeing strategy, culture, risks and controls

- Voting on material corporate matters, including capital allocation, M&A and other material transactions
- Hiring, firing and compensating the CEO and directors
- Holding senior management accountable for performance
- Reviewing succession plans
- Overseeing compliance with applicable law

These governing fiduciary boards are usually bigger than advisory boards, at 7 to 12 members, and members are compensated.

Positioning your company for progress

A well-constructed board takes time and effort, but it can greatly increase your company's chances of success by giving credibility to an emerging enterprise, providing needed skills as the organization expands, and offering perspective and guidance as the company scales. Investing time and energy in building the right board at the right time is well worth the effort of an ambitious startup entrepreneur with big plans.

Insights, tools and analysis on the issues and trends impacting board directors can be found at the EY Center for Board Matters.

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