

Outside Directors: Do You Need Them and Where to Find Them

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STARTING UP: *Practical Advice for Entrepreneurs*

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Outside Directors Do You Need Them and Where to Find Them

In the past two weeks I have attended Board of Director meetings of five different privately held entrepreneurial companies. Three were required to elect a representative of their venture capital investor firm to the Board. The other two had sought out good outside directors for other reasons. What if you don't have outside investors or if you are not required by your financing sources to have an active Board- should you bother?

The Basics. As a matter of law a corporation must have a Board of Directors. The directors are elected by the stockholders and have the responsibility as the representatives of the stockholders to oversee corporate operations. In the United States a Director in his or her capacity as a director does not have the power to sign contracts or commit the corporation legally. The Board elects the officers, who are responsible for the day to day running of the corporation and who have the power to sign contracts under provisions of the bylaws, corporate law and specific Board authorization. There is no limit on the number of directors which a corporation can have. A Delaware corporation can have as few as one director. A Massachusetts corporation needs only one director if there it has only one stockholder, two directors if only two stockholders and three directors if there are three or more stockholders.

Beyond the Law. So the short answer is "yes, your corporation does need a Board of Directors"- it's required by law. But let's get to the more interesting question- "who should be on the Board?" I have read many business plans and have observed many entrepreneurial startups. Experience tells me that a venture with a Board of Directors consisting of management and family or friends is a real "red flag" situation. Usually management has its nose so in the day-to-day short term firefighting trenches that it can easily miss the big picture forces which can make or break the venture. Having your only "outsiders" being friends or family members usually doesn't make the situation any better because it either gives you a false sense of "everything is going well" or can degenerate into interpersonal issues which are unrelated to the business. I have another client who I had been after for four years to get some outside board members but he kept procrastinating. Finally he took in some venture capital money and had to have a "real Board". After three months of a "real Board" he not too grudgingly admits that he should have done this sooner.

A Director's Job Description. So you are convinced, or are at least willing to consider, that an active outside Board of Directors is a good idea. What do you look for in a Director and how do you find them? Approach Board composition the way you hire employees. What job/role do you need represented on the Board? Consider preparing a job description to help you figure out what type of person you need on your Board. Directors can have

relevant industry experience, general business experience, growth company experience, financing expertise, strategic contacts, financial community credibility and many more attributes. Which is most critical for your business? Not every director will have all of the desired attributes and not all of these attributes may be needed at the same time- some are more important in the short term while others might be more critical over the longer run. However, think twice before you invite someone on the Board who will not be making a sustained long term contribution to the company. When you have a discrete short term non-repetitive task in your business you usually don't hire a full time employee to do it. Instead you might use an independent contractor or a part-timer. The same applies to Directors.

Hunting for Directors. Where do you find these director types? There is no one place, but it is like fishing- to catch bluefish go where the bluefish are. Ask other entrepreneurs where they found their directors. Check with your accountant or lawyer. Look around industry associations- the Massachusetts Software Council, the MIT Enterprise Forum, etc. Read Boston Business Journal to find an entrepreneur who has just sold his or her business and might have time available. Check out annual reports of public companies to find their directors or perhaps their senior management. The National Association of Corporate Directors has an active New England chapter. As with any hire, do your homework and check the references and reputations of your potential directors.

Closing the Deal. In a recent survey discussed in a Deloitte & Touche publication "the opportunity to contribute and be part of a force for change" was cited by 74% of Fortune 1000 directors as the single most important reason for being a director, followed by "respect for the CEO" at 61%. I have seen very busy people respond very favorably to an approach which says in effect "I have a specific role which is important to me for these reasons, I believe you would be perfect in this role for these reasons." With this approach even if the person can't commit to being a director you probably will win the admiration of the person and perhaps even support on specific less time demanding tasks you might have in the future. Be sure to make sure you and the director candidate have calibrated on the time commitment expected/available.

Compensation. You should certainly pay all expenses of your directors for their Board related activities. Venture capital representative directors are usually not separately compensated for director duties. According to one study, in 1995 directors of public manufacturing companies with under \$200 million in sales received a median of \$18,500 in compensation and approximately 81% of the companies used a combination of a yearly retainer and per meeting fee – see National Association of Corporate Executives (www.nacdonline.org). However, a privately held growth company probably can't afford to pay good directors in cash what they are really worth. Stock or options are a nice way of handling this and relatively small amounts can work for compensation for normal director activity. Separate consulting services provided by directors should be the subject of separate compensation. Although situations differ, remember that most directors value the experience of working with energetic management and other quality people- that is most likely their real reward.

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