

BDC STUDY

ADVISORY BOARDS: AN UNTAPPED RESOURCE FOR BUSINESSES

March 2014



EXECUTIVE SUMMARY

BDC undertook the first-ever Canadian study on the use of advisory boards by small and medium-sized enterprises (SMEs). The study describes how advisory boards work in these businesses and quantitatively demonstrates that SMEs that use them have superior growth and better financial results.

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ADVISORY BOARD STUDY HIGHLIGHTS

6%

**of Canadian SMEs
have access to
an advisory board
that helps them
manage their business**

**Canadian SMEs
with advisory
boards perform
better financially
than those without
advisory boards**

- > BDC undertook the first-ever Canadian study on the use of advisory boards by SMEs. To do so, it used a rigorous qualitative and quantitative research methodology. The study revealed that 6% of Canadian SMEs have access to an advisory board. Furthermore, they are most often found in SMEs that have been in business for 11 to 20 years, businesses that have 20 or more employees, and businesses operating in the distribution, business services and manufacturing sectors.
- > The main reasons that prompt SME leaders to set up advisory boards are the desire for complementary expertise, and the need for advice and support in decision making. In fact, 86% of leaders believe that having an advisory board has had a significant impact on the success of their business. Areas of impact most often cited are company vision, innovation, risk management and profitability.
- > When forming an advisory board, SME leaders usually seek skills in accounting or finance, sales, marketing, and human resources, as well as knowledge of their industry. Generally meeting on a quarterly or monthly basis, most advisory board members offer their advice and expertise free of charge.
- > Statistical analysis of businesses' financial variables based on fiscal data from Statistics Canada shows that:
 - Sales growth was stronger after instituting an advisory board. In the first three years after an advisory board was set up, sales grew 66.8% compared with a growth of 22.9% in the three previous years.
 - Productivity growth also strengthened after the advisory board was introduced. In the three years after the advisory board was set up, productivity rose an average of 5.9% compared with 3.2% in the previous three-year period.
- > The study also compares the financial performance of businesses that have advisory boards with similar companies without a board. The study shows that, from 2001 to 2011:
 - On average, annual sales of businesses with an advisory board were 24% higher than those of the control group during the period.
 - Productivity (as measured by the ratio of sales to the number of employees) was 18% higher on average for the group of businesses with advisory boards.
- > It is, therefore, not surprising that 80% of business leaders with advisory boards say that if they had to do it again, they would set up another advisory board.

INTRODUCTION

It is often said that a company's success and sustainability rest on solid governance

It is an indisputable fact that SMEs contribute significantly to economic growth, job creation, innovation and business renewal. For these reasons, governments in several countries have made considerable efforts to facilitate the creation of new companies and encourage the success of established companies. Offering direct and indirect financial support, a simplified regulatory landscape, tax incentives to boost investments and providing access to applied research centre innovations are among the measures often used.

While these are important to the survival and growth of any business, other internal factors also play a critical role. The leader's expertise, management and networking skills, and putting in place a solid corporate governance are also major success factors. In fact, it is often said that a company's success and sustainability rest on solid governance. For an SME, this can take the form of an advisory board that provides strategic advice and guidance. Unlike a board of directors, it has no decision-making powers and no legal liability towards the company.

While we may assume that having an advisory board contributes to a company's success, existing literature does not provide any supporting empirical evidence. In fact, few studies on governance specifically address the question of advisory boards. As such, we did not know how many companies in Canada have access to such boards. This study aims to fill this information gap and gain a better understanding of the reasons motivating SME leaders to set up an advisory board. It is also designed to determine whether the presence of an advisory board has a positive impact on the financial performance of an SME.

GOAL OF THE STUDY ON THE IMPACT OF ADVISORY BOARDS ON SMES

Very few studies address the impact of advisory boards on SMEs

The question of corporate governance is a topic of great interest in financial and economic literature. Several studies have analyzed the separation of powers between shareholders and business leaders (the 'Agency Theory') as well as the effect of the composition and independence of a board of directors. Some have tried to make a link between certain characteristics of a board of directors and a company's success.¹ However, most of these studies look at publicly listed companies, often much larger in size and easier to observe.

Privately owned SMEs have a different governance structure than large corporations. Some governance experts believe that a traditional board of directors is too formal for an SME, and suggest that advisory boards are better adapted to their needs.² However, other than guides on how to set up an advisory board and its benefits, very few studies focus on the impact of advisory boards on SMEs.

For example, we do not know how many SMEs in Canada currently have an advisory board. Is this method of governance more widespread than a board of directors? What are the differences in impact between the two types of governance? Can one draw a cause and effect link between an SME's governance structure and its commercial success? Many of these questions remain unanswered. In large measure, this is why we undertook this study and focused on the use of advisory boards.

From the outset, we can assume that an advisory board brings tangible benefits to a company, such as an external perspective and expert advice. Almost by definition, the board requires a company to be more reflective, and pushes it to build a long term vision. This leads us to believe that business owners with advisory boards likely develop greater rigour, and are better able to strategically orient their companies and take the necessary steps to reach their objectives. However, these are just hypotheses.

1. Lawal, B., *Board Dynamics and Corporate Performance: Review of Literature, and Empirical Challenges*, International Journal of Economics and Finance, Vol. 4, No 1: January 2012.

2. Allali, B., *Conseils d'administration de PME : un examen de la documentation*, HEC, Cahier de recherche 2002-2006.

2. STUDY METHODOLOGY

This study therefore aims to discover the existence, composition and operation of advisory boards in Canada and determine if empirical data supports the assumption that an advisory board has a positive impact on the performance of privately owned SMEs in Canada. To do so, we used a two-phase approach.

In the first phase, we conducted a survey of more than 1,000 SME leaders across the country after completing a literature review and in-depth interviews with governance experts and entrepreneurs with advisory boards and/or boards of directors.

To understand the impact of advisory boards from the perspective of leaders of privately owned Canadian SMEs, BDC asked Saine Marketing to conduct a survey of privately held SMEs in Canada to find out the proportion that have an advisory board, to learn more about their composition, how they operate and the impact they have. We also wanted to draw a portrait of those companies with advisory boards and understand why some companies choose to have them while others do not. The first step was to hold 12 in-depth interviews with SME governance experts and small business owners that have advisory boards. These interviews allowed us to delve into the subject, better define the scope and develop a questionnaire which was then used to conduct a survey of more than 1,000 Canadian SMEs.

Taking into account current definitions and the comments made by specialists and SME owners, our definition of “advisory board” for this survey is as follows:

“A group of independent people who advise the management team of a company on specific problems and who meet on a regular basis. Unlike a board of directors,³ the members of an advisory board do not have the authority to vote on business matters nor do they have any legal responsibility towards the company. The company has no obligation to implement the advisory board’s recommendations.”

Most of the interviews were conducted over the telephone between November 28 and December 18, 2013, and only a few were completed online between December 5 and 27, 2013. The survey had 1,047 respondents (999 telephone interviews and 48 online interviews). This survey has a margin of error of 3.1%, with a confidence interval of 95%. The results were weighted based on region and company size.

In the second phase, we undertook a thorough analysis of BDC clients that have advisory boards to establish quantitatively whether these businesses perform better than similar companies without advisory boards, including whether they do better financially after setting up advisory boards. The results of both analyses are presented in this report.

3. In comparison, the term “board of directors” designates a group of persons elected or appointed to manage a company, who have a legal responsibility towards the company and who meet on a regular basis.

3. ANALYSIS BASED ON THE PERCEPTIONS OF SME LEADERS WITH ADVISORY BOARDS

6%

of all Canadian SMEs have an advisory board

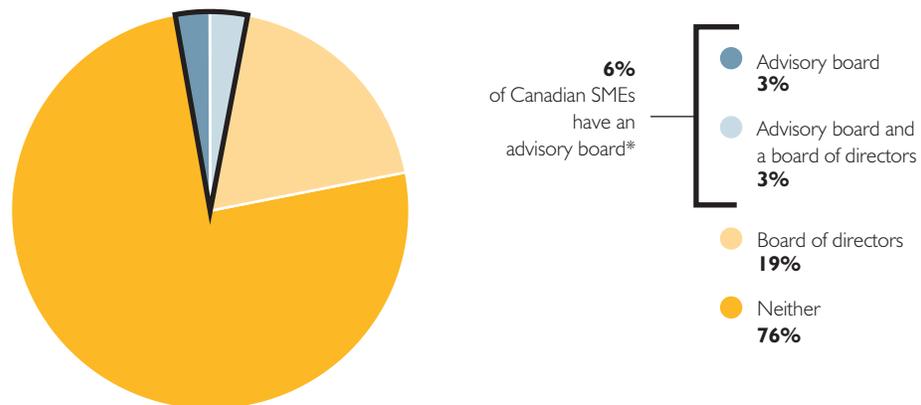
19%

of the country's SMEs only have a board of directors

3.1 PREVALENCE OF ADVISORY BOARDS

The survey showed that 6% of all Canadian SMEs have an advisory board. Of these, half (3% of the total) set up advisory boards when they also had a board of directors. Moreover, 19% of the country's SMEs only have a board of directors. The study does not make it possible to establish the proportion of SME boards of directors that play a truly strategic advisory role (in the style of advisory boards) or simply fulfill their legal obligations. Lastly, three-quarters of SMEs have neither an advisory board nor a board of directors.

Figure 1: Prevalence of advisory boards



Source: Saine Marketing, January 2014, n = 1,047

*Numbers have been rounded, resulting in a total of 101.

12%

in the distribution sector

9%

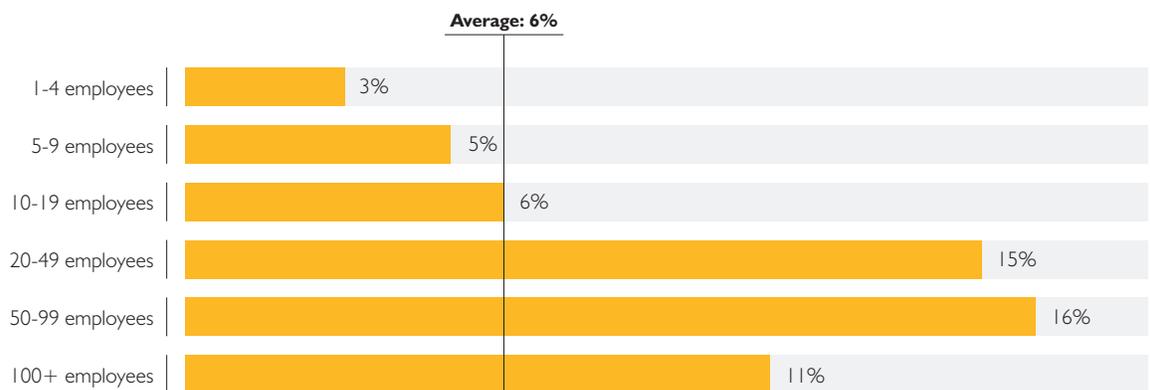
in the business services sector

9%

in the manufacturing sector

The profiles of Canadian SMEs with advisory boards differ slightly from those that are without. Firms with 20 or more employees are more likely to have advisory boards, as the following graph shows.

Figure 2: Prevalence of advisory boards by company size



Source: Saine Marketing, January 2014, n = 1,047

One finds a larger proportion of businesses with advisory boards operating in the distribution (12% of sector businesses), business services (9%) and manufacturing (9%) sectors. This is also the case for companies that are 11 to 20 years old (8%).

3.2 TRIGGERS

SME leaders set up advisory boards for a number of reasons. In order of magnitude, the most frequently mentioned are the desire for complementary expertise (21% of respondents), the need for advice and support in decision making (20%), the view that it is a sensible business decision (17%), and for help with growing the business (13%).

Moreover, 14% of companies with a board of directors also decided to set up advisory boards. They use their advisory boards to gain access to expert opinions and advice. In these cases, the advisory board generally reports to the board of directors. The board of directors plays a decision-making role and handles administrative and legal matters. In this way, the board of directors and the advisory board complement each other's work.

Role of an advisory board according to an SME business leader

It is not unusual for the CEO of an SME to be a “one-man band,” personally seeing to every detail and micromanaging his business. Isolated, he tends to manage everything himself. According to Jean-Yves Sarazin, CEO of the Delom Group, an advisory board allows entrepreneurs to break free from their isolation and to have a sounding board to validate their strategies. An advisory board allows business leaders to question themselves and forces them to reflect. The mission of an advisory board is to ask the most relevant questions and delve deeper into underlying issues. It can also help compensate for weaknesses. An entrepreneur who lacks financial expertise can benefit from the recommendations of an advisory board member who has financial expertise. Moreover, an advisory board forces the leader to be prepared, triggering the thinking process: *[Translation]* “When preparing, one often self-corrects one’s strategy. Having an advisory board builds discipline.”⁴

4. Extract from a case study conducted by Chirita, Chapdelaine and Fillion of HEC Montréal, 2010.

3.3 BENEFITS ACCORDING TO LEADERS

As a governance tool, advisory boards are not common among Canadian SMEs. However, according to business leaders who have set them up, they yield tangible benefits. When asked to rate the advantages on a scale of one to 10, they responded that the advisory board:

> is an essential tool	8.2
> is like having a sounding board	8.1
> is a support for the owner/management team	8.1
> allows you to develop a broader vision	8.0
> strengthens the management team's convictions	8.0
> forces management to look at the company	7.5
> challenges the company's management team	7.5
> brings rigour in to the company	7.2
> is a driving force for the growth of the company	7.1

In particular, the existence of an advisory board allowed them to:

> improve strategic business choices	8.0
> broaden the universe of knowledge and skills	7.8
> develop new ideas	7.8
> put in place a better management structure	7.4
> improve company reputation and image	7.3
> reassure shareholders and investors	7.2
> avoid costly mistakes	6.7
> break down the isolation of company executives	6.4
> ensure succession of the company	6.1

86%

of respondents who have benefited from the advice of their advisory board believe it has had a significant impact on their company

3.4 IMPACT OF ADVISORY BOARDS

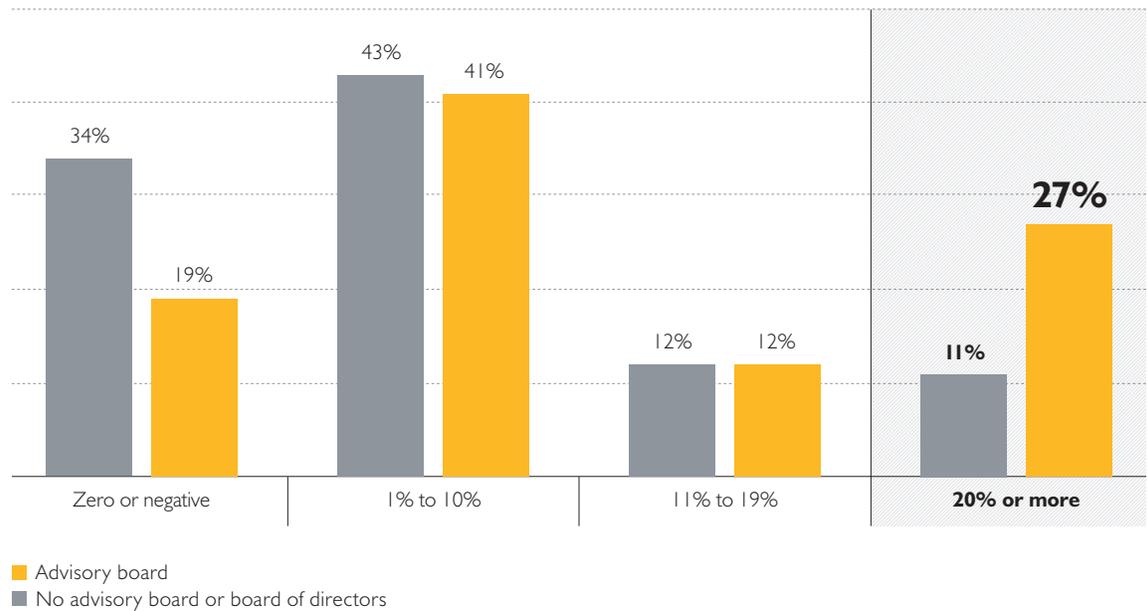
Most (86%) respondents who have benefited from the advice of their advisory board believe it has had a significant impact on their company. In particular, respondents note that advisory boards had a direct, positive impact on:

> company vision	7.7
> innovation within the company	6.9
> risk management	6.8
> company profitability	6.8
> company survival	6.6
> sales growth	6.6
> labour relations	6.5
> hiring the best employees	6.2

These results clearly show that an advisory board improves the company's vision and enables better strategic decisions. Moreover, an advisory board encourages entrepreneurs to think long term and define a direction for their company.

According to SME leaders, these elements have a positive commercial impact. In fact, 27% of businesses that set up advisory boards are high growth, i.e., have experienced average annual sales growth of 20% or more over the last three years. In comparison, only 11% of businesses without advisory boards or boards of directors have reached this level of growth. As well, fewer companies with advisory boards posted flat or negative growth during this period (19% versus 34%).

Figure 3: Average annual growth by sales or total revenue over the last three years*



Source: Saine Marketing, January 2014, n = 1,047
 *Due to rounding, numbers in each category may not total 100.

In addition, leaders of Canadian SMEs that draw on advisory boards are more likely to consider growth projects or restructuring their operations (58% versus 35% for those without advisory boards or boards of directors), as well as expansion plans into new local markets (56% versus 34%).

It therefore seems that the benefits of having an advisory board largely offset the time investment required to set up and run an advisory board. Eight out of 10 businesses would not hesitate to repeat the experience.

3.5 OBSTACLES TO CREATING ADVISORY BOARDS

Given the positive impacts mentioned above, why have so few Canadian business leaders taken the initiative to set up an advisory board? In fact, survey results showed that 6% of those without advisory boards have already considered setting one up. The main reason they have not yet done so is the belief that it involves too much work, time and effort (57% of respondents).

This perception is not entirely incorrect, since almost half (48%) of all business leaders with advisory boards state that it generates substantial work for management. On the other hand, 45% of them believe that the benefits of an advisory board should be promoted more. These benefits must not be underestimated.

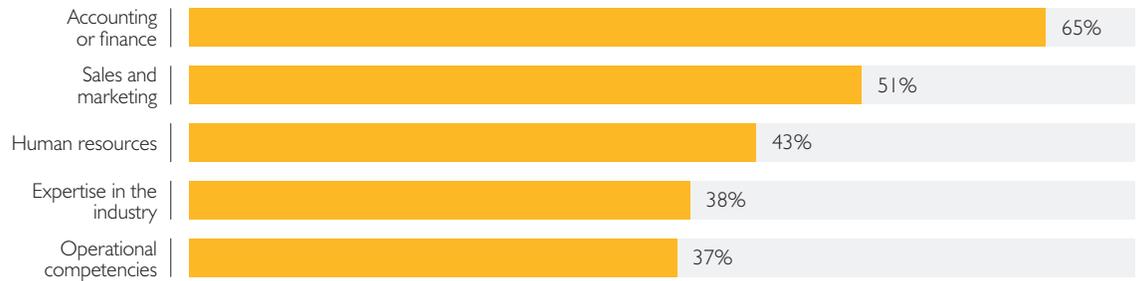


Advisory boards, on average, consist of five people

3.6 COMPOSITION AND OPERATION

The Saine Marketing survey also collected information on the composition and operation of advisory boards. On average, they consist of five people. The skills sought most frequently by management are accounting or finance (65%), sales and marketing (51%), human resources (43%), expertise in the same industry (38%), and operational competencies (37%).

Figure 4: Competencies most frequently sought for advisory boards



Source: Saine Marketing, January 2014, n = 1,047

In the majority of cases (56%), advisory board members are recruited through the company's network of contacts. In 8% of cases, companies used external recruiting methods, such as professional services, a private firm or association, or advertising. Only 3% of the respondents relied on the services of their financial institution or an investor. It should be noted that 18% of leaders with an advisory board would like or would have liked help in recruiting members.

In order of importance, advisory board members are made up of business contacts and individuals with no ties to the business. Occasionally, they are employees (usually shareholders), shareholders or family members.

Advisory board members meet regularly, generally on a monthly or quarterly basis (six out of 10 times). Moreover, most advisory board members agree to offer advice and counsel free of charge. Less than half (43%) of the respondents reported that they paid advisory board members. This compensation was often a set amount per meeting or simply a reimbursement of travel costs.

4. IMPACT OF ADVISORY BOARDS ON COMPANIES' FINANCIAL RESULTS

This study also seeks to establish whether setting up an advisory board has had a positive impact on a company's financial results. To do so, we conducted a study of BDC clients from 2001 to 2011. We examined two aspects, namely:

- > Did these companies have better financial results than a group of businesses that did not have an advisory board and were similar in terms of size, industry, age and region (study group and control group)?
- > Did these companies have better financial results after implementing an advisory board (before-and-after analysis)?

4.1 METHODOLOGY

The following methodology was used:

- > We randomly contacted 31% (8,785 businesses) of our 28,000 clients and validated if they had an advisory board and the year in which their advisory board or board of directors was set up. Our response rate was 47% (4,123 businesses). We excluded those that set up advisory boards or a board of directors after 2009, providing us with a database of 3,902 businesses.
- > We then asked economists at Statistics Canada's Canadian Centre for Data Development and Economic Research⁵ to compare this client database with the Business Register and their administrative and tax databases (i.e., those containing financial information on Canadian businesses and the number of employees). By linking these databases, we obtained a longitudinal database of companies that had or did not have an advisory board for the period of 2001 to 2011.
- > To conduct the statistical and econometric analyses of this database, we retained the services of Marcel-Cristian Voia, PhD in Applied Econometrics and Associate Professor at Carleton University's Department of Economics in Ottawa.

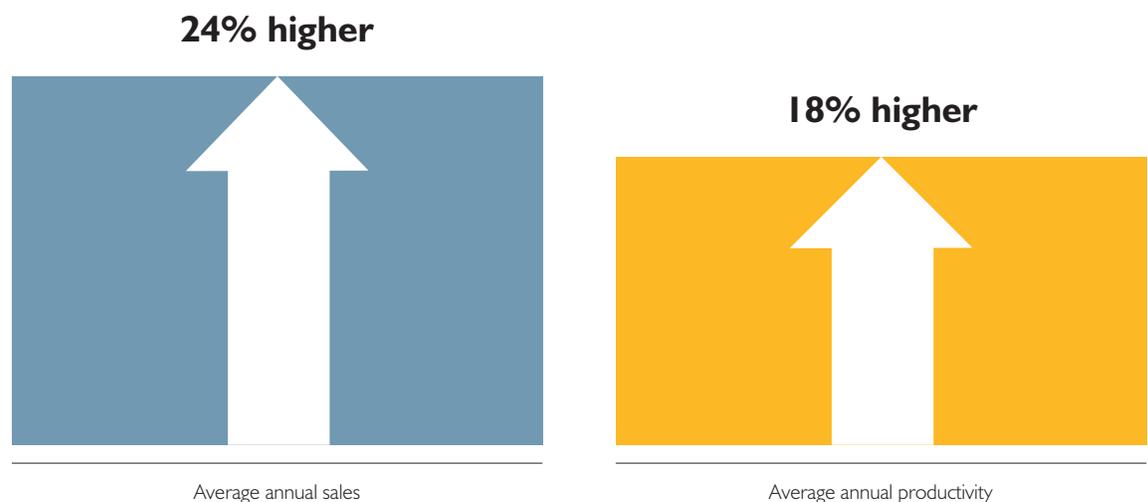
5. The research and analysis are based on data from Statistics Canada and the opinions expressed do not represent the views of Statistics Canada.

4.2 ANALYSIS OF THE STUDY GROUP AND CONTROL GROUP

Analysis of the group of companies with advisory boards (study group, 307 observations) and the group of similar companies in terms of the number of employees, industry, age and region that do not have advisory boards (control group, 300 observations) shows that between 2001 and 2011:

- > The annual sales of the study group were 24% higher on average than those of the control group throughout the period. In fact, study group businesses posted average annual sales of \$2.868 million while the control group recorded average sales of \$2.31 million.
- > Productivity, measured by the ratio of sales to the number of employees, was 18% higher on average in the study group than in the control group.
- > Profit growth was higher for the group with an advisory board (study group).

Figure 5: Average annual sales and productivity of SMEs with advisory boards compared with SMEs without advisory boards



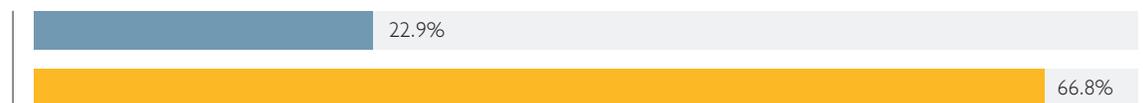
4.3 BEFORE-AND-AFTER ANALYSIS

Statistical analysis of the companies' financial variables before and after advisory boards were established (study group only) showed similar results:

- > Stronger sales growth was recorded after an advisory board was established. In the three years after the advisory board was set up, sales growth of 66.8% was reported versus 22.9% in the three years before the advisory board was established.
- > Productivity growth was also stronger after the advisory board was put in place than before. In fact, in the three years after the advisory board was set up, productivity was up by 5.9% on average while it increased by 3.2% on average in the preceding three years.
- > On average, profit growth was also stronger once the advisory board was established than before.

Figure 6: SME sales and productivity growth before and after the introduction of an advisory board

Sales



Productivity



- Three years before
- Three years later

These two statistical analyses show that advisory boards have a tangible and real impact on the financial performance of Canadian SMEs.

CONCLUSION

An advisory board helps leaders develop a long-term vision for the company and take informed strategic directions

Canadian SMEs with advisory boards perform better financially than those without advisory boards

Although abundant, the economic and financial literature on corporate governance has little to say about the existence and impact of advisory boards on Canadian small and medium-sized businesses. This is what motivated this study. The two types of analysis performed, one qualitative (based on the perceptions of business leaders) and the other quantitative (based on a thorough analysis of a longitudinal database of BDC clients), yield clear conclusions.

In fact, while only a small proportion of Canadian SMEs have advisory boards, they reap very tangible benefits. First and foremost, an advisory board helps leaders develop a long-term vision for the company and take informed strategic directions. According to our study, SMEs see real advantages to advisory boards, something confirmed by our examination of the financial data. The benefits speak for themselves. The empirical results of the two approaches to creating and analyzing data converge. In other words, both the survey data and Statistics Canada's financial data on BDC clients conclude that Canadian SMEs with advisory boards perform better in terms of sales, productivity and profitability than those without them.

In fact, from 2001 to 2011, the average annual sales of businesses with advisory boards were 24% higher than those of comparable companies. Moreover, productivity was 18% higher on average over the same period. Additionally, in the three years following the establishment of an advisory board, sales grew 66.8% compared with 22.9% over the previous three years. Productivity growth was also higher after the introduction of an advisory board. In fact, in the three years after an advisory board was set up, productivity increased an average of 5.9%, compared with an increase of 3.2% over the three previous years.

As a result, leaders believe that the benefits brought by advisory boards more than compensate for the effort required to set them up and they would not hesitate to do so again. This suggests that the role, operation and benefits of this governance tool should be highly promoted to Canadian business leaders in order to help them manage their company's success.

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