The impact of Advisory Boards on small business

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 and evaluate if the presence of an advisory board has a positive impact on the financial performance of an SME. The study revealed that 6% of Canadian SMEs have access to an advisory board. They are most often found in SMEs that have been in business for 11 to 20 years, have 20 or more employees, and operate in the distribution, business services and manufacturing sectors. Canadian SMEs that have advisory boards perform better in terms of sales, productivity and profitability than businesses that do not have such boards.

Introduction

It is an indisputable fact that small to medium-sized enterprises (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 measures often used.

While these are important to the survival and growth of any business, other internal factors also play a deciding 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 strength rests on solid governance. For an SME, this can take the form of an advisory board that provides 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 do 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 and the resulting benefits. We also want to understand how an advisory board differs from a board of directors. Lastly, we want to learn if the presence of an advisory board has a positive impact on the financial performance of an SME.

1. Corporate governance in 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 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

[1] Lawal B., *Boards Dynamics and Corporate Performance: Review of Literature and Empirical Challenges*, International Journal of Economics and Finance, 2012.

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

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 forces greater accountability and reflection, and pushes a company 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. This study looks at the presence of advisory boards in Canada and determines if empirical data supports the assumption that an advisory board has a positive impact on privately owned small to medium-sized enterprises in Canada.

2. Survey of Canadian SMEs

To answer the above-mentioned objective, we conducted 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 board 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 (that is no family or direct business link with owners, management or shareholders) who advise the management team of a company on specific problems and who meet on a regular basis (about 3-4 times a year). 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 toward the company. The company has no obligation to implement or not the recommendations of the advisory board."

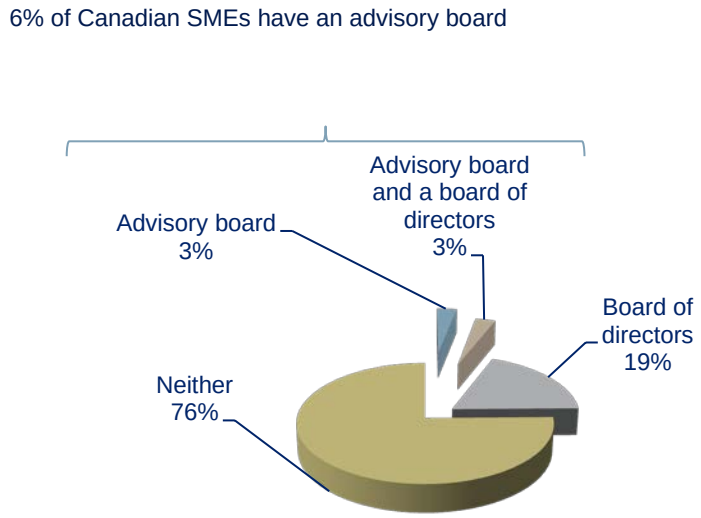
Most of the interviews were conducted over the telephone between November 28 and December 18, 2013, and only a few were completed online between December 5 and 27, 2013. The survey had 1,047 respondents (999 telephone interviews and 48 online interviews). This survey has a margin of error of 3.1%, with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

2.1 Existence of an advisory board in SMEs

The survey showed that 6% of all Canadian SMEs have an advisory board. Of these, half (3% of the total) also have a board of directors. A board of directors (with no advisory board) is found in 19% of Canadian SMEs, while three-quarters have neither.

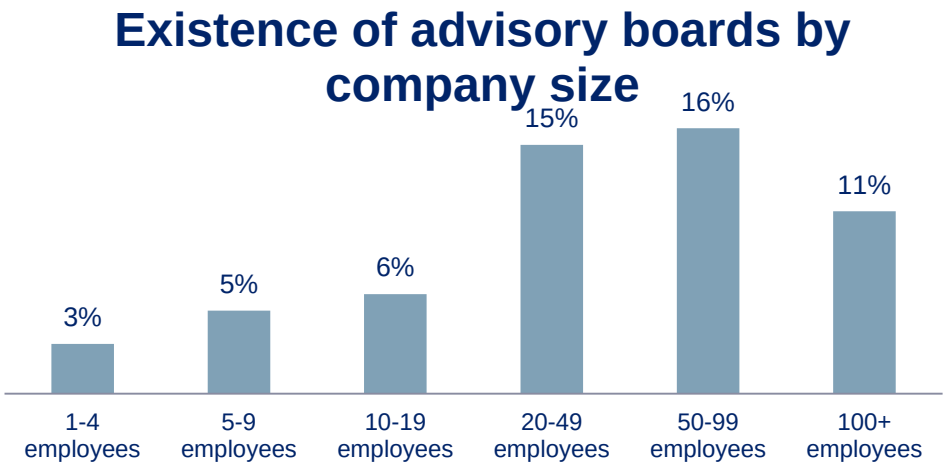
[3] In comparison, the term "board of directors" designates a group of persons elected or appointed to manage a company, who have a legal responsibility towards the company and who meet on a regular basis.

Figure 1: Existence of an advisory board



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:



A larger proportion of advisory boards is found in companies operating in distribution (12% of sector businesses), business services (9%) and manufacturing (9%), and in companies that are 11 to 20 years old (8%).

2.2 Triggers for establishing advisory boards

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%).

Some companies that have boards of directors also decided to set up advisory boards. They use their advisory boards to gain access to expert opinions and advice, while the boards of directors play a decision-making role and handle administrative and legal matters. In these situations, the board of directors and the advisory board complement each other's work.

2.3 Benefits of advisory boards

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 beliefs of the management team (8.0)
- forces management to look at the company (7.5)
- challenges the management of the company (7.5)
- brings rigour in 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 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 making costly mistakes (6.7)
- break down the isolation of company executives (6.4)
- ensure succession of the company (6.1)

2.4 Impact of advisory boards

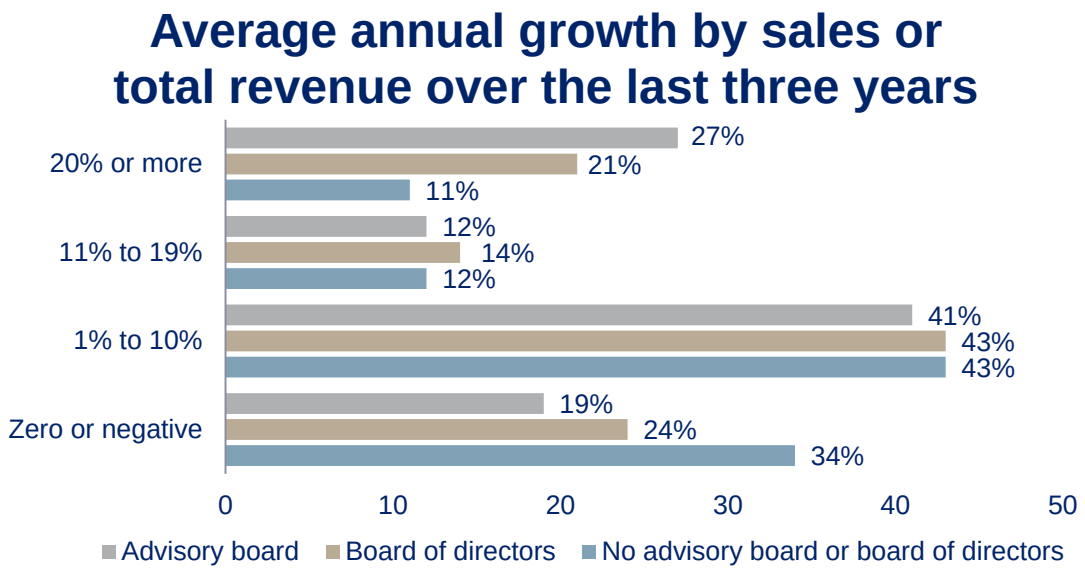
The majority of respondents (58%) who have benefited from the advice of their advisory board believe it has had a very big impact on the company. In particular, respondents note that advisory boards had a direct, positive impact on:

- company vision (7.7)
- innovation within the company (6.9)
- risk management (6.8)
- company profitability (6.8)
- survival of the company (6.6)
- sales growth (6.6)
- labour relations (6.5)
- hiring the best resources (employees) (6.2)

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

These elements had a positive impact on commercial success. Businesses that set up advisory boards are more likely to have experienced average sales growth of 20% or more over the last three years (27% versus 11% for companies without advisory boards or boards of directors). As well, fewer of them posted flat or negative growth during this period when compared to those without (19% versus 34%).

Figure 3:



Moreover, 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 plans to expand into new local markets (56% versus 34%).

Lastly, the majority of business owners feel that the benefits of having an advisory board offset the time investment required. When asked whether they would set up an advisory board again, eight out of 10 businesses would not hesitate to repeat the experience.

3. Impact of advisory boards on companies

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

- Did these companies perform better than a group of similar businesses in terms of size, industry, age and region without an advisory board (analysis between a study group and a control group)?
- Did these companies perform better after setting up an advisory board (before-and-after analysis)?

3.1 Methodology

The following methodology was used for the analysis:

- Based on a total of 28,000 clients, we contacted 31% of them at random (8,785 businesses) and validated whether they had an advisory board and the year in which their boards were set up. Our response rate was 47% (4,123 businesses), from which we excluded those who set up their advisory boards after 2009, thus providing us with a database on 3,902 businesses.

- We then compare this client database with the Business Register and their administrative and tax databases (i.e. the one 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 between 2001 to 2011.

3.1 Analyses of the study group and control group

The analyses comparing the group of companies that have advisory boards (study group) and the group of similar companies in terms of the number of employees, industry, age and region (control group) that do not have advisory boards show that between 2001 and 2011:

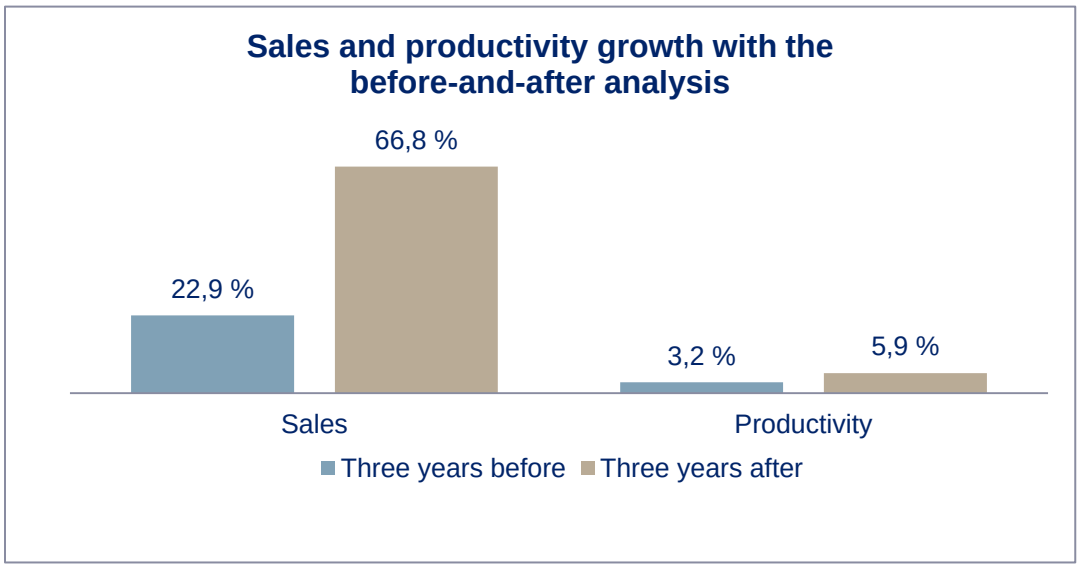
- The annual sales of the study group were on average 20% higher than the control group's throughout the period. In fact, the businesses in the study group posted annual sales of $2.9 million on average while the control group recorded average sales of $2.3 million.
- Productivity, measured by the ratio of sales to the number of employees, was 18% higher on average in the study group vs. the control group.
- The group that had an advisory board saw higher profit growth.

Before-and-after analysis

The statistical analyses of the companies' financial variables before and after advisory boards were set up (study group only) showed similar results:

- Stronger sales growth was recorded after an advisory board was established. As such, in the three years after the advisory board was set up, sales growth of 66.8% was reported vs. 22.9% in the three years before the advisory board was established.
- Productivity growth was also stronger after the advisory board was instituted than before. In fact, in the three years after the advisory board was set up, productivity was up by 5.9% on average vs. a 3.2% average increase in the preceding three years.
- Profit growth was also stronger on average, once the advisory board was up and running vs. before.

Figure 5:



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

Conclusion

The study shows that 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. The results of these decisions speak for themselves: not only have SMEs with advisory boards experienced stronger sales growth over the last three years than those without, but fewer of them have stagnated or shrunk.

Canadian SMEs that institute an advisory board show increased sales, productivity and profitability vs. their counterparts that do not have advisory boards. In addition, once SMEs set

up their advisory boards, they experienced stronger growth in terms of sales, productivity and profitability.