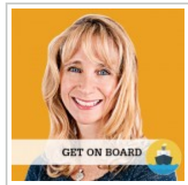
# What to know before you compensate advisers with equity

**Compensating your advisory board with equity and stock options**

*By Marissa Levin*




One of the most common questions asked about forming an advisory board is, "Should I give my advisers equity in my company?" Whatever reasons lead a business owner to compensate advisers with equity, it's essential to understand the legal, financial and tax implications. Wayne Zell, a principal at law firm Odin, Feldman & Pittleman, shares his tips regarding how to issue equity and stock to advisory board members in a way that protects all parties.

My 90-minute conversation with Zell revealed important information for all business owners considering issuing equity and stock to their advisory board members.

## Four scenarios

There are four basic ways you can compensate advisers using equity:

**Shares of stock** offer direct ownership interest in the company, either voting or nonvoting. If it's voting stock, they will have a direct say in company decisions.

**Options to purchase shares of stock** give the right to acquire stock. Many companies use this model so that you don't have a right to participate immediately, but you'll have the right to participate in the future — with future earnings, future value and potential voting rights — if you exercise your option.

**Stock appreciation rights and phantom stock** are very similar. Both represent a form of deferred compensation — you never really acquire an ownership interest in the company, but you can participate in the upside of a company if it's sold or certain criteria are met.

## Structuring incentives

According to Zell, many CEOs like to give a lot of equity up front because they feel desperate. They need an adviser's help to bring in a big contract, help implement a critical process, improve operations or find financing. But it's a risky proposition.

To reduce risk, make sure to tie performance criteria to the grant. For instance, "For every million-dollar client that you introduce to us, we will give you a half-percentage of the company." Without any performance criteria attached to the grant, there's no way to know if the adviser will deliver, and you'd be giving away chunks of your company for nothing in return.

Another approach Zell recommends: Rather than gifting a big chunk of equity up front, stage it over time — as your advisers work with you, they earn more. He offers this scenario:

"You might give someone a half a percentage a year for four years. That takes them to 2 percent. You might think, '2 percent is not that much, is that really an incentive?' But if you are growing [the business] to $50 million, that's $1 million. That's not a bad gig for helping someone part-time to grow their business."

Another reason this approach works: As the value of the company increases, the price the adviser has to pay to buy it at some point is also increasing. As a result, they have to invest more as the company grows.

## Writing agreements

As in all business relationships, it's important to carefully document agreements with advisory board members. Advisory board member agreements can be specific to each member or uniform to all, says Zell.

"If you're going to give them shares, you will need a shareholders' agreement or a restricted stock agreement in place that spells out the grant of equity," he specifies. "This is in addition to the advisory board member agreement you will provide."

Over time, advisers may become dissociated with the company. Or maybe they've fulfilled their purpose — "they've done what they can do," as Zell puts it — and aren't performing. That's why it's critical to create a strong shareholders' agreement that allows the company and majority owners to buy back their shares at market value.

Creating the advisory board agreement will take a few hours of a lawyer's time, but the stock agreement could cost anywhere from $3,000 to $5,000, Zell says. As your attorney tailors it, it could cost even more. Zell advises CEOs to develop a standard set of forms so they don't have to reinvent the wheel for each adviser.

With these documents, you can develop an overall company plan that can be used to give equity to lots of people: employees, vendors, consultants and even to partnerships with investors and banks. This is a great option for bootstrapped companies. **CEO**

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