

# Insights

## **Three Minute Update – Doing a Deal: Stacking the Deck - the Law and Best Practices for Building Your Board**

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Every day businesses at home in Indiana and across the country rely on the resources and capabilities of their workforce to accomplish their goals. As leaders of these organizations will tell you, the heart of any well-run business is a dedicated team of competent individuals. When evaluating a business's human capital, an often-overlooked asset can be found in its own board of directors or board of managers ("Board"). Chosen wisely, these groups of individuals are essential to the company and the company's success.

In addition to choosing the right people to serve, setting up a framework and structure within the company in which these individuals operate will be just as important. For instance, if the rules or framework are too informal (or, worse, without a proper structure), the Board may bring little value or direction to the company. In contrast, if the rules are too rigid or strict, the Board may become too formalized and overbearing, leading to a loss of talent or worse. The decision to start and lead a business in Indiana requires important and careful considerations of these issues.

Achieving the proper balance in structuring the powers and responsibilities of a Board with the right people to fill those seats takes insight and can be a complicated and nuanced process, best done with the guidance and experience of professional legal and other advisors to the company. To this end, a few key points frequently appear in our practice.

### **Where to start?**

Two of the most important threshold questions to ask when starting a business in Indiana are: (1) what type of business entity should be chosen and (2) who should be involved. Indiana law allows several types of business entities, each with certain requirements, flexibilities, and limitations. Of the several types of business entities, the most well-known are the corporation and limited liability company. While Indiana's laws (like those of all other states) mandate certain requirements and provide a basic framework for corporations and limited liability companies, Indiana law provides some significant flexibility in how these entities can structure their internal operations and controls. Often, the internal structure and balance of power and duties within these entities will be as unique as the businesses themselves.

### **When choosing an entity, what does the law require?**

Under Indiana law, every corporation with over fifty (50) shareholders—both for-profit and non-for-profit—is required to have a board of directors, which serves as the internal corporate body to exercise or oversee all corporate powers vested in the corporation. This includes adopting corporate policies, raising capital, electing officers, and setting certain strategic goals. Indiana corporations with fifty (50) or fewer shareholders may dispense with the board of directors entirely or may limit the authority of the board of directors as described in the corporation's articles of incorporation. Importantly, every Indiana corporation with a board of directors must have at least one (1) director, although the articles of incorporation or bylaws may prescribe a higher number. To provide flexibility to the corporation, a director need not be a resident of Indiana or even a shareholder of the corporation to serve as director, provided the articles or bylaws do not provide otherwise.

Limited liability companies in Indiana, by statute, have even greater flexibility in designing and implementing a management structure. Unlike corporations, by default the management of a limited liability company's business and affairs is vested with its members, unless the company's articles of organization specify otherwise. The articles of organization may also provide for the company to be managed by one or more managers, a seemingly analogous structure to that of a corporation. The company's operating agreement can then establish the procedures and authorities under which the managers must act, which may function much in the same way as a corporate board of directors.

### **What type of authority does the Board have?**

One of the essential questions that should be considered when drafting or revising an entity's governing documents relates to the scope of authority granted to the Board or retained by the owners (i.e., the shareholders in a corporation or members of an LLC). This question can only be answered after significant analysis of the specific facts, goals, and objectives surrounding each business and the needs and/or desires of its owners. While Indiana law provides for certain threshold requirements, the options available to the Board are nearly endless. For instance, the owners of a company can give the Board significant authority for day-to-day operations of the company and only reserve fundamental rights for a full vote of the owners, or, on the other hand, the owners can position the Board as an intermediate authority between the officers and the shareholders. Sometimes, a corporate board of directors may seem only advisory without any real authority if sufficient approval rights are reserved to the owners. This can be true in LLCs as well. The needs of the business, the investors, and the officers will play a key role in deciding what authority a Board should have.

### **Who should serve on the company's Board?**

With the right framework in place, the company also needs to decide who will fill the seats on the Board. These decisions can be as important as the framework.

Entities are empowered under the law to devise their own policies and procedures for selecting Board members. While some practices for selecting Board members are dependent on the direction and strategy of the existing business and must be specifically tailored, one practice should underpin any Board's strategic vision: attracting and retaining diverse talent. When current Board members are tasked with recruiting new Board members, an often-unintentional consequence is the next iteration of the Board "looks like" the previous Board. Getting stuck in such a

It can be a detriment to the businesses strategic growth. It can also be contrary to a Board's responsibility to build and preserve value for the owners. Recent guidance shows that companies with diverse Board members and management teams outperform those that are not diverse.

Market analysis suggests that diversity on a company's Board, including a variety of experiences, perspectives, competencies, philosophies, ages, genders, cultures, and ethnicities, enhances an internal leadership structure based upon shared values and better reflects and represents the interests of the company's stakeholders and its employees, customers, and, ultimately, community at large.

Ensuring diversity of the company's Board can start with the foundational documents or the early actions of the Board. In either scenario, the directors, managers, and members should strive to develop and implement Board diversity objectives and policies at the earliest opportunity. Company decisionmakers should look to their strategic vision for guidance. For instance, among the questions leaders can ask, consider the following examples: is the company focused on growth into new geographic or product markets? Is the company in the service industry and needing to attract new talent and ideas? Is the company civic-oriented/non-for-profit and needing to engage stakeholders from different cross-sections of the community the company seeks to serve? Answering these questions can help inform and guide the initial Board's policy decisions.

When structuring a new business, owners are allowed practically limitless options under the law. Indeed, these varied options can be overwhelming for many business owners trying to navigate the hurdles of corporate governance. With the help and guidance of experienced legal counsel, marrying the company's vision, capabilities, and expectations with the appropriate legal form and structure can help guide the company to success.

If you have any questions regarding the information in this article or with board formation generally, contact **George C. Lepeniotis, Alex C. Bowman**, or any member of our **Business, Acquisitions, & Securities Practice**.

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