In collaboration with

Board evaluation

What the Board and Company Secretary need to know

When a Board hits the front page of the newspaper as a result, for example, of corporate failure, questionable ethics or conflict within the Board, the damage has been done and remedial action is either impossible or comes at a considerable cost. The challenge for all Boards is to act before there is a crisis.

Performance evaluation is a major means by which Boards can recognize and correct such corporate governance problems and add real value to the organizations they govern. It is a key component of the performance management system for any Board.

How can a Board ensure that it is carrying out its governance obligations and making the most of its talents available to it? While events such as unanticipated corporate failure and public Board conflict are glaring signs of governance failure, they occur far too late for Boards to take effective remedial action.

If Boards are to meet business and community expectations by providing effective corporate direction and control, they require a way to know things are going awry long before enormous costs for investors, employees, customers, and the community become unavoidable. It appears likely that these community expectations of Boards will continue to rise, and that Boards will come under increasing pressure to recognize and correct corporate governance failures.

Changing attitudes to performance measurement

The pressures on a Board to drive corporate performance mean that performance management and measurement are integral to a Board's success. Performance measurement drives organizational learning and growth, and performance measures that use appropriate indicators ensure that the operations of an organization are aligned with its strategy. As a result, performance management systems have become sophisticated and popular at all levels of organizations.

Resistance to Board evaluation process

In spite of many benefits of Board evaluation, Boards have generally been slow to adopt the practice. A number of reasons why Boards are still resistant to the concept of Board evaluation are referred to below:

- Reluctance due to proven track record of directors
- Misconception that the performance appraisal will undermine the effectiveness of the team
- Shareholders feedback only appraisal methodology
- Misconception that it is impossible to establish objective evaluation criteria.
- Absence of guidance on how boards should conduct an effective evaluation process.
- Lack of agreed standards to guide boards in the development of an evaluation process
- The evaluation process is too time-consuming
- Formal evaluation processes will expose the Board to the danger of liability
- Governance not being given the necessary importance

Advantages of Board evaluation

While it is important to be able to overcome resistance when developing a governance evaluation approach, it is also necessary to understand the advantages of the process. Board evaluations, if conducted properly, can contribute significantly to performance improvements on three levels: organisational, Board and individual Director level. Boards that commit to a regular evaluation process find benefits across these levels of improved leadership, greater clarity of roles and responsibilities, improved teamwork, greater accountability, better decision making, improved communication and more efficient Board operations.

Some key benefits of Board evaluations include:

- It can strengthen the Board's leadership role
- It improves role clarity
- Teamwork can contribute to performance improvement
- Accountability is one of the important issues driving calls for corporate governance reform
- Improvements in the Board's decision-making process
- Improvement of Board communication
- Effective Board operations

Framework for a Board evaluation

It is important that a proper framework for the Board evaluation process is in place. Aligned with international best practice, there are seven key questions to consider when planning a Board evaluation. These are:

- What are the objectives?
- Who will be evaluated?
- What will be evaluated?
- What techniques will be used?
- Who will do the evaluation?
- What will you do with the results?

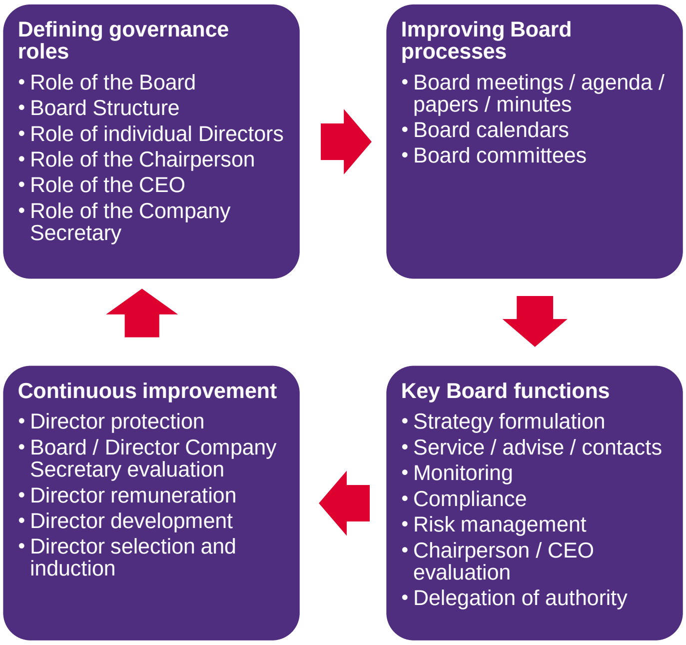

Diagram 1: The corporate governance charter model

Setting the objectives

This is the critical first stage of an effective Board review process. Although most Directors and Managers recognize the importance of setting objectives in the day-to-day management, too often little thought is given to this important topic when undertaking a governance evaluation. Setting objectives for the review process should be guided by one simple question: "What does the Board hope to achieve by doing the review?". In practice, there will usually be several aims for the review, but it is important that the Board focus on the top three or four that will really make a difference to their performance.

The first decision for most Boards to consider is the overriding motivation for the evaluation process. Generally, the answer to this question will fall into one of the following two categories:

1) Corporate leadership

- We want to clearly demonstrate our commitment to performance management
- We believe reviewing our performance is essential to good governance
- We want to provide Directors with guidance for their learning and growth
- We want to ensure our governance demonstrates best practices
- We want to ensure our governance is continually improving

2) Problem resolution

- We are not sure if we are carrying out good governance
- Our governance (or some areas) is ineffective
- There are problems in the dynamics in the boardroom
- There are problems in the dynamics between Board and management
- We are not utilizing our Directors as well as we could
- We do not seem to have the appropriate skills, competencies, or motivation on the Board

Design question / objectives	To understand why our Governance system does not seem to work	To see if our Board meetings have improved since last year	To improve the Board's information flow / have the right information
Who will be evaluated	• Board as a whole • Management • Chairperson • Company Secretary	• Board as a whole • Chairperson • Company Secretary	• Management • Company Secretary
What will be evaluated	Board questions to elicit what people see as the problem	• Meeting efficiency • Meeting effectiveness	• Board papers • Management presentations
Who will be asked	• All key governance personnel • External experts	• Directors • Chairperson • External experts	• Directors • Management • Company Secretary
Who will do the evaluation	External expertise	Internal lead	Internal lead
What techniques will be used	Qualitative interviews	Emphasis on quantitative for comparison	Mix of qualitative and quantitative
How will outcome be broadcast	Within the Board until we understand how to address them	Externally to show improvement	Internally to management so that they can address them

Table 2: How objectives influence the decision-making process

Motivation	Categorization	Dimension	Examples of objectives
Corporate leadership	Best practice	• The overall governance system • Individual governance functions	• We believe reviewing our performance is essential to good governance • We want to ensure our governance demonstrates best practice • We want to ensure our role in strategy is effective • We want to be sure we have a best practice audit function
	Culture formation	• Within the boardroom • For the company	• We want a process that encourages candid debate in the boardroom • We want to clearly demonstrate our commitment to performance management
	Development	• For the governance system • For Board members • For other individuals	• We want to ensure our governance is continually improving • We want to provide Directors with guidance for their learning and growth • We need to provide the Company Secretary with performance feedback
Problem resolution	Identifying problems	• Unsure of the unknowns • Unsure of root cause • Unsure of common understanding of problems	• We need to identify what aspects of governance are neglecting • Our monitoring does not appear to be working and we need to find out why • We need to come to a shared understanding of the issues in risk management
	Improving dynamics	• Between Board members • Between the Board and management • With external stakeholders	• We need to improve the atmosphere in the boardroom • We need to improve Board-management interactions • We need to provide Shareholders with confidence in our transparency
	Competence	• Of the Board as a whole • Specific functions of the Board • Of individual Board members • Specific governance roles	• Ensure the Board has the breadth of attributes required of it • Ensure we have the skills to carry out effective crisis management • Ensure each Director applies themselves to the task • Ensure we have a competent CEO

Table 3: Possible governance review goals

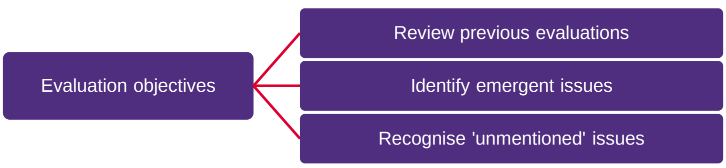

Diagram 4: Setting evaluation objectives

Who will be evaluated?

With the objectives for the evaluation set, the Board needs to decide whose performance will be reviewed to meet them. Since the Board is collectively responsible for the governance of an organization, nearly all evaluation objectives will require the Board to evaluate its own performance. Comprehensive governance evaluations can entail reviewing the performance of a wide range of individuals and groups. Pragmatic considerations such as cost and time constraints, often preclude such a wide-ranging review.

Alternatively, a Board may have a very specific objective for the review process that does not require the review of all individuals and groups, as set out in Diagram 5. In both cases, an effective evaluation requires the Board to select the most appropriate individuals or groups to review based on its objectives.

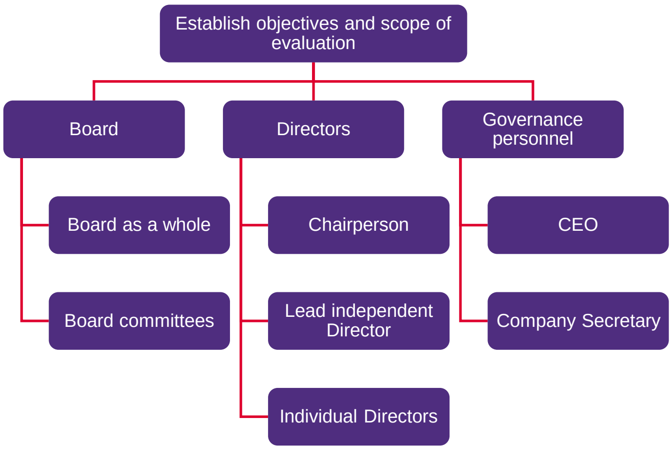

Diagram 5: Who will be evaluated?

What will be evaluated?

The evaluation objectives need to be elaborated into a number of specific topics to ensure that the evaluation clarifies any potential problems, identifies the root cause(s) of these problems, and tests the practicality of specific governance solutions, where possible. The corporate governance charter model (Diagram 1) provides some key advantages when using it in refining specific objectives into questions for evaluation.

One way to ensure that the evaluation does not overlook areas of potential improvement, is to make use of a Governance Framework. By using such a Framework, the Board ensures that it deals with all areas of concern. It will also allow the Board to identify the root cause of the problem, as well as will it allow the Board to test possible solutions for the Board.

Deciding what to evaluate is one of the most difficult and yet critical components of the evaluation process. The evaluator faces a delicate balancing act between ensuring the questioning is extensive enough to identify the root cause(s) of the issue, yet manageable enough to satisfy the scope and resources constraints of the review.

Who will be asked?

If a Board is committed to improving its performance, there are many sources of valuable information. When selecting an appropriate data source, the Board should aim to collect the most accurate and reliable information available. Sometimes, the best information will be obtained from the board members themselves. At other times, it will add value to the process to approach other sources, either within the organisation or externally. Multiple data sources provide multiple perspectives on a problem and may provide the Board with additional insights.

Internal sources of information are valuable because they represent the opinions of people who are familiar with the workings of the Board and the needs of the organisation. External data sources provide objective information and new perspectives on a performance problem. They enable a Board to benchmark its performance against that of similar Boards and to gain credibility with external Shareholders.

The key to choosing the most appropriate sources of information is to gain a comprehensive set of data that balances objectivity of feedback with boardroom familiarity.

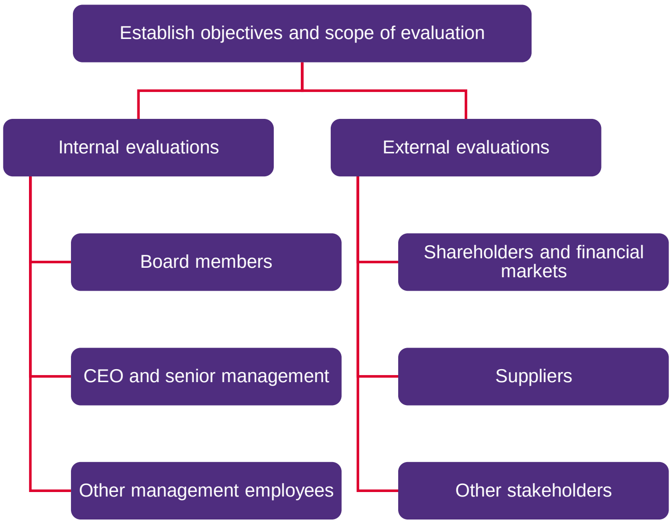

Diagram 6: Who will be asked?

Evaluation techniques

There are two types of data – quantitative data and qualitative data.

1) Qualitative analysis

Most Boards undertake evaluations without a clear view of the issues at hand. When the evaluation's objectives are to identify governance problems, screen alternative solutions and / or uncover new approaches, qualitative research come to the fore.

Qualitative data does have several drawbacks, however. The major drawback is that interpreting the results requires judgment on the part of the person doing the review and analysis. Conclusions can be subject to considerable interpreter bias, even where the person conducting the review is a Board member. This is best addressed by using experienced researchers for the task.

While observation and evaluation of written documentation are used in some Board evaluations, interviews are the preferred tool of analysis for the majority of Boards. Interviews allow individuals to express their personal points of view in an informal manner. They are confidential and encourage Directors to discuss Board performance openly. The interview technique is particularly suitable for Boards wanting to explore one or two major issues in depth.

2) Quantitative analysis: survey

While quantitative data lack the riches of qualitative data, they have the advantage of beings specific and measurable. This enables the evaluation to count, compare and contrast individual responses both over time and between individuals. Surveys are by far the most common form of quantitative technique used in governance evaluations and can be an important information-gathering tool. It is vital to understand that surveys are attitudinal instruments. Surveys measure individuals' subjective assessments of particular topics and are subject to responder bias. Despite the extensive use of measurement to assess these attitudes, the responses are no more or less valid than qualitative research. Objectivity is not obtained through numerical representation.

Data type	Typical governance research questions
Quantitative data	• How much better (or worse) have our Board meetings become? • How much difference of opinion is there between the Board and management about the Board's role in strategy? • How far behind best practices are we in the area of Director induction?
Qualitative data	• What is causing dissension in the boardroom • Why can't we seem to get through the agenda? • When should the Board become involved in risk management? • Do we have an appropriate compliance system?

Table 7: Quantitative and qualitative research questions

3) General research

Research techniques need to be adapted to the evaluation objectives and Board context. In particular, the research designer needs to be aware of the advantages and disadvantages of the various techniques. Qualitative techniques provide rich data, but the logistics of collecting and analyzing the data are difficult. Quantitative analysis, on the other hand, is based on reducing the data or phenomena in question to numbers. This is not nearly as informative as qualitative data, but it can be readily collected from a large number of people or other sources, and is very easily consolidated, compared and / or benchmarked. The choice of techniques will depend on the Board's objectives.

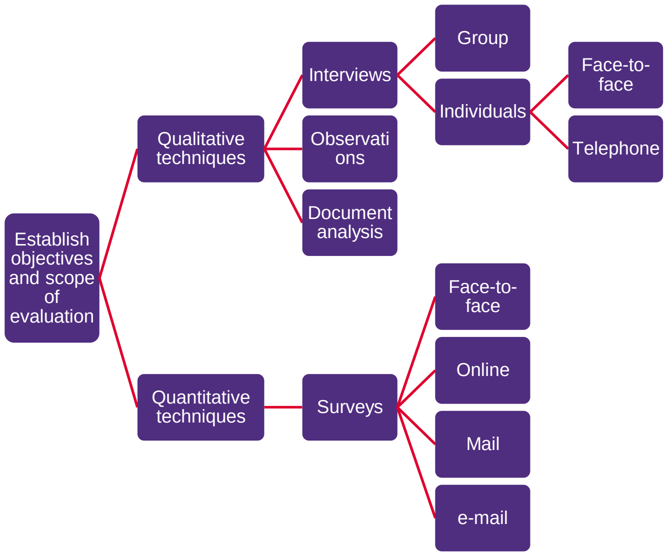

Diagram 8: Evaluation techniques

Who conducts the evaluation process?

The major decision for the Board is whether someone within the company or an external party will conduct the review. Internal reviews are generally conducted by the Chairperson, or the lead independent Director. If the Chairperson is also the CEO, a nominated non-executive Director, or a committee of the Board will conduct the internal review. External reviews tend to be conducted by either general advisors or specialist consultants.

1) **Internal reviews**

These are traditionally the most common of Board evaluation and have a number of advantages:

- By conducting an internal review, the Board is asserting its autonomy to set and apply its own standards.
- Internal reviews are a heightened assurance of confidentiality that comes with a Board member conducting the process. Internal reviews can be useful teambuilding exercises.

- Internal reviews generally have the advantage of being a more cost-effective option.

2) **External reviews**
There are a number of situations where Boards find it preferable to engage external consultants or advisers to facilitate the Board evaluation. Boards tend to seek external evaluation facilitators in two generalized circumstances, namely where there is a significant requirement for transparency, and / or where the Board does not have the capacity to carry out the evaluation itself. External consultants can also prove valuable in a number of special circumstances. See Diagram 9 and 10 for an illustration.

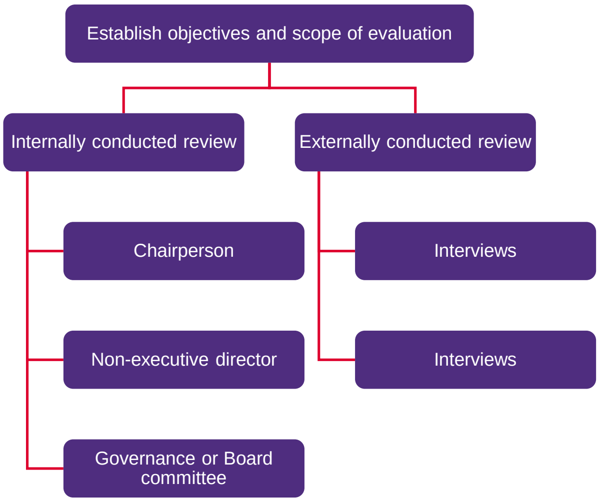

Diagram 9: Who conducts the evaluation

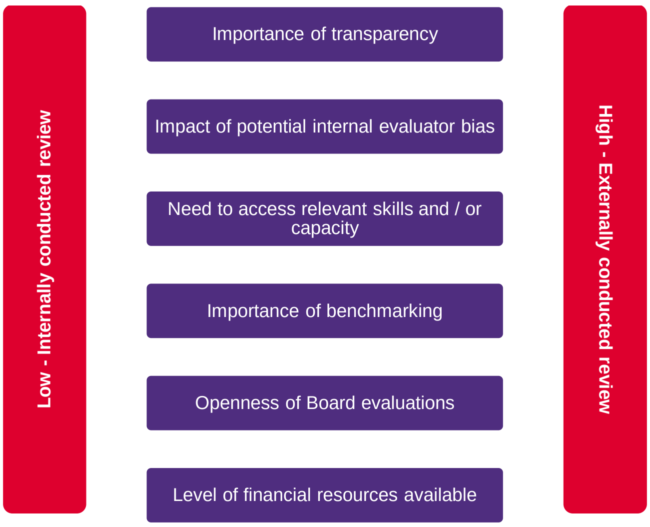

Diagram 10: Deciding between an internal and external review

Communicating the results

Communicating the results of a Board evaluation can serve many purposes. It can lead to personal development plans for individual Directors, more cooperation and teamwork between Board members, better relationships between the Board and management, and stronger, better relationships with external stakeholders. However, for these benefits to be realized, it is important to observe three rules:

1) Respect the confidentiality of all participants
2) Wherever possible present summary data only
3) Select the medium (e.g. private conversation, workshop, media release) for disseminating the results that is appropriate to the stakeholders being informed and the objectives of the evaluation.

Respecting confidentiality is essential to successful outcomes for a performance review. No performance evaluation can be successful if the participants do not trust each other. Closely allied to this issue is ensuring that summary data only is presented for discussion. This is because it is important not to attribute particular statements or opinions to individuals. This is the usual practice unless there is a high level of trust between the Board members.

It is essential that the outcomes of an evaluation indicate issues on which the Board is divided, because it is only through resolving these issues that performance can be enhanced. However, it is not appropriate to disclose the source of the information.

Finally, it is important to choose the right medium to disseminate the outcomes of the review. This choice will be dictated by the original objectives of the review. If the objective of the review is to introduce performance evaluation for the first time, informal discussion of the issues and outcomes of the process will preserve a spirit of collegiality and serve to build trust between Directors. If the objective is to demonstrate transparency in its proceedings, it may wish to release information to selected stakeholders, such as Shareholders. How widely information is disseminated will depend on the Board balancing the need to preserve confidentiality with the need to disclose outcomes to key stakeholders.

Implementation

"Any improvement, when first installed, is likely to contain some embedded flaws. Accept this as plain fact and do not allow it to become the reason for delaying the plan's implementation" – Wilson & Pearson.

Regardless of differing review objectives and consequent review activities, successful Board evaluations follow a broad four-stage implementation process.

1) A Board needs to determine its objectives and assigned responsibility for the task
2) Gather the requisite data and carry out an appropriate analysis

3) Board take time to meet and discuss the findings of the data-gathering and analysis stage
4) Post-implementation follow-up to ensure that the agreed action plans are being implemented.

When finalizing the implementation process, Boards generally consider the effectiveness of the evaluation and how often they should perform such appraisals. Some Boards decide to evaluate their performance on an “as needed” basis. Other prefer to conduct a major review every two or three years. Many Boards conduct an annual or semi-annual review, while others opt to include performance evaluation as a regular agenda item at each Board meeting.

The regular meeting review

Some commentators believe that performance evaluation should be an ongoing process, not just an annual event. High-performing Boards tend to devise other mechanisms apart from an annual review to ensure ongoing performance development. One option is to review the effectiveness of each Board meeting. This can be scheduled as a regular agenda item, with the Directors taking turns to lead the discussion.

The technique involves the appointment of one Board member to act as the ‘meeting evaluator’. This person observes the participants and assess the content and importance of items on the agenda, as well as the quality of the Board papers. The evaluator then gives his / her opinion in a five-minute review at the end of the meeting. The other Board members are then asked for their comments on the effectiveness of the meeting and to offer suggestions for improving performance. The whole process is intended to last no more than 10 or 15 minutes. This is a simple technique for keeping performance issues ‘front of mind’ for the Board. It is an easy way to gain feedback and to encourage discussion and interaction between Board members. It requires little time and effort to put in place.

Conclusion

“Behavioral psychologists and organizational learning experts agree that people and organizations cannot learn without feedback. No matter how good a Board, it is bound to get better if it is reviewed intelligently.” – Sonnenfield

Performance evaluations are becoming increasingly important for Boards, Chairpersons, CEOs, Directors, and the companies that they lead. Pressure for improved evaluation is coming from two main sources. First, King IV™ strongly recommends the conducting of Board evaluations, along with other international Corporate Governance Codes. Second, there are clear performance benefits to companies when their leaders are willing to engage in open and honest appraisal of their own performance.

Evidence suggests that an integrated performance evaluation system that links Board and CEO performance to the achievement of organizational goals is a strategic asset, not just a monitoring system.

Boards also need to recognize that planning the evaluation process is a team building activity and a practical way of ensuring buy-in to the process and outcomes. Unfortunately, Boards that fail to engage their members are missing a major opportunity for team building. The process is as important as the content.

Sources
King IV™ Code on Corporate Governance
Kiel, Nicholson, Barclay: Board, Director and CEO Evaluation Celagenix®
Corporate Academy - Governance Division

Contact a specialist

Find out how Grant Thornton can help you to ensure that your organisation has effective corporate governance measures in place.

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