Feature

Evaluating board performance

Alex Cameron looks at how to get beyond the tick-box when evaluating board performance.

The Financial Reporting Council (FRC) states that 'High quality corporate governance helps to underpin long-term company performance', and the UK Corporate Governance Code (the Code) aims to encourage companies to achieve this aim. The FRC has used the Code to spread best boardroom practice throughout the listed sector since it was first issued in 1992. Recent company failures, executive remuneration and several scandals have shone a light on boardroom operation, and the results have damaged many reputations at corporate and personal levels. So the Code is necessary to give confidence to shareholders and other stakeholders that each board is operating effectively – it's hard to imagine a dysfunctional board leading a highly successful company. However the Code, no matter how comprehensive and insightful, is only as good as its implementation and so the board evaluation process is a critical component in attaining high quality corporate governance.

The need for effective board evaluation

Consider the tensions designed into the standard operation of boards; for example the tensions between the different perspectives of executives and non-executives or between the roles of CEO and the Chairman. Then consider the need to get to the heart of these relationships if the evaluation process is going to be effective and there are a number of typical issues that the board evaluation process may need to address.

- *Board challenge and scrutiny is perceived as limiting the freedom of the executive directors*. Naturally most executives want as much freedom as possible from board scrutiny they don't want the board to slow down or change their decision-making. This tension between the executive and non-executive directors is designed into the board process for good reasons.

- *Non-executive directors perceiving that their scrutiny and input is being overlooked in board decision-making*. Sometimes, seen as outsiders, the non-execs can feel overlooked or marginalised by the board process. In these situations, the board cannot get full value from the experience that non-execs can and should bring to board decisions.

- *Tensions between the CEO and the Chairman*. This is a critical one-to-one relationship and one on which much of the conflict resolution and smooth operation of the board hangs. This relationship demands time so that both parties really understand how the other operates and a degree of trust is built up. However, if problems arise, the Senior Independent Director's (SID) contribution needs to be scrutinised.

- *Poor communication between the board committees and the whole board*. The network of committees carries out a range of important roles on behalf of the board, however in some situations, they can be perceived as operating too independently of the whole board. This again is critical area for the attention of the Chairman.

So the internal structure of any board has the potential to create tensions. To some extent these tensions are designed into the system in order to increase the effectiveness of decision-making for the benefit of the whole business, but this decision-making can only take place if the dynamics of the board are right. This need is well recognised in the latest edition of the Code[1], which makes particular reference to the area of board dynamics. In the section on leadership the Code looks at the division of responsibilities, the leadership provided by the Chairman and the constructive challenge provided by the non-execs. The challenge is for the board evaluation process to unearth honest feedback on these issues.

A framework for evaluating board dynamics

The traditional approach to board evaluation is driven by a set of questionnaires that each member of the board is required to complete. These questionnaires (often disparagingly called tick-boxes by board members) allow board members to score the performance of their colleagues and the board as a whole. Generally they are of very limited use for a number of reasons. The scoring does not encourage feedback that can lead to positive development of board operations and it discourages honest critical feedback – especially to individuals in key roles eg the Chairman and to any board members who are disruptive in board meetings! This approach also tends to miss out providing data on other challenges that can face any board, for example succession and the skill mix of the group.

The first step is to find a framework or model that will focus on the critical areas of board dynamics and support the requirements of the Code. Our experience suggests that collaboration must be at the core of effective board functioning and decision-making. And there appear to be three contributing factors that, in balance, will form the foundations of effective boardroom collaboration:

- *Board operations* – the processes, mechanics and sources of information that ensure that the board is an efficient structure with internal good communication;

the effectiveness and communication with the board committees.

- *Board governance* – how the board directs its efforts for the benefit of the business; its contribution to the business strategy, the appropriateness of board appointments and its attention to the management of risk and internal controls.

- *Board behaviours* – the quality of relations between board members (both within the formalities of a board meeting and more informally outside), the contribution from each of the board roles, the dialogue with shareholders and the effectiveness of board collective decision-making.

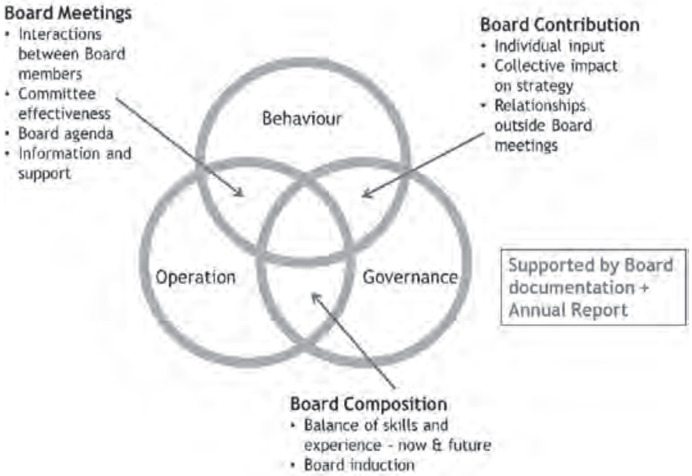
A thorough board evaluation process based on the principles enshrined in the Code can provide the vehicle to help the board develop the way individuals work together within this framework of effective operations, governance, and behaviours. The evaluation process can achieve this by examining the following three areas:

- *Board composition* – exploring how the balance of board skill and experience meets the business need now and into the future.

- *Board meetings* – reviewing the efficiency and effectiveness of the meetings where most of the board's decisions are taken.

- *Board contribution* – examining individual and collective impact along with critical board relationships.

The figure below indicates how an effective evaluation process, which pays attention to board meetings, contribution and composition, will address the three foundations of collaboration; board operations, governance, and behaviours. In our experience this evaluation and development process cannot depend on checklists, surveys and questionnaires. These techniques work for the components of the board evaluation process which audits the process and procedures of the board. This can usually be covered with the board secretary, but face-to-face interviews are required to elicit quality feedback on board performance and board dynamics. Naturally, the more procedural elements of the Code will require the evaluator to review documentation, but this is never a substitute for direct dialogue with board members.



The skills of evaluation and how to use them

It is important that the board evaluation is carried out dispassionately but also sensitively. In our experience boards can sometimes find the idea of an external evaluation of how the board operates threatening and unsettling. The most enlightened boards use the process to address sometimes longstanding issues or topics where an outside perspective is valuable, eg succession. In fact, some boards are using external evaluation more regularly than required by the Code.

Good practice suggests that the evaluator should take care to engage with the board and address all concerns at each stage of the process, dealing sensitively with any inter-personal issues. This means:

- Agreeing with the Chairman how the output of the review will be delivered to the whole board, giving time to fully discuss the recommendations.

- Meeting the whole board together at the start of the process to explain the evaluation, agree the ground rules and address concerns.

- Holding one-to-one meetings with board members in relaxed surroundings out of the office if that makes the environment conducive to openness.

- Giving sufficient time to the board secretary to fully cover the procedural demands of the Code.

- Highlighting where the executives' and non-executives' views on board performance diverge.

- Debriefing the Chairman on the results of the evaluation and meet with any individual board member if there is a need to feedback sensitive information.

- Delivering the results directly, concisely without any temptation to 'sweeten the pill' and offer to meet with board members individually after the presentation if they would like to discuss the recommendations in detail as it applies to them.

- Ensuring that the evaluator reviews the wording about the evaluation that is to be inserted into the Company Report and Accounts.

No matter how effective the framework of the board evaluation, the effectiveness of the whole process comes down to the skills of the evaluator and how they apply those skills in order to build trust and encourage openness. The evaluator needs to be clear about the boundaries of their role and absolute in the need to maintain confidentiality with board members. As well as being expert in good governance and the demands of the Code, the board evaluator needs the following skills and attitudes:

- A listener – to draw out information from board members without judgement

- High EQ (emotional intelligence quotient) – to understand and handle the relationships issues that can underpin the working of the board

- A mediator – to help resolve any areas of conflict between board members
- An analyst – synthesise the feedback and present the conclusions succinctly to the board.

If the evaluator can demonstrate these skills when following this approach to board evaluation, then it is our belief that they can demonstrate the value of thorough and sensitive board evaluation by an external expert. And, in doing so, this approach to board evaluation fully meets the intention of the FRC and the objectives of the Code – without the use of tick boxes.

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[1] UK Corporate Governance Code – FRC – Sept 2012.