



HARCOURT BOARDROOM RESOURCES

BOARD EVALUATION PROCESS



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BRIEF HISTORICAL REMINDER

In today's business environment no responsible board can seriously refuse to "evaluate" itself. This was not always the case, and the fact that it is now universally accepted does not mean that the evaluation process is carried out properly, not that it is easy to make meaningful. At first glance, the idea that boards should be evaluated does seem to be particularly revolutionary. After all, managements are evaluated, and management assessments have always been the norm. Assessment tools at all levels of the hierarchy have become quite efficient and sophisticated. Why would boards not also be evaluated?

Despite the apparently obvious nature of an evaluation of the board, the reality is that it has only quite recently been introduced in governance codes. Until the financial crisis, board evaluation was neither generalized nor was it seriously implemented, even in countries or companies that proudly claimed they had an evaluation board process.

A board was – and still often is – composed of local "grandees", making the idea that these important people should be assessed rather awkward. It wasn't clear who on the board or in management should conduct the exercise, and third-parties had little experience in board assessments. Some directors simply refused to be evaluated, taking very personally the suggestion that they might be. When boards did go through an evaluation, it was formal rather than substantive. Rarely, if ever, were the individual contributions of directors looked into and challenged.

Things have changed since the financial crisis. Fingers have been pointed at the incompetence of boards, at their inept composition and inefficient behaviors. Lawmakers, regulators and stock-exchange authorities have, almost without exception, either introduced the requirement that boards conduct an annual evaluation, or strengthened the requirement significantly, in particular with respect to periodicity and disclosure.

This requirement has been in line with the evolution of the increased role of the board and the pressure put on boards to perform. The extreme situation is in the banking sector, where the directors have to be (formally or informally) approved by the regulator, who can also interview

the candidates beforehand, and then interview directors on a regular basis once they have become part of the bank board.

Even more important than a new regulatory environment, the culture also has changed. The fact that board assessments are now widespread makes it more acceptable for everybody to be assessed. A board that does not conduct an annual evaluation process is an "out-layer", and trying to justify not doing one is a lost cause.

So boards now take the assessment process seriously. But this does not make it any easier, smoother and more useful. Many boards are frustrated by this annual process. They find it formalistic, disconnected from the reality of the business and cumbersome. Everybody agrees that, if it were well handled, the exercise could be very useful indeed. By how?

PURPOSE OF THE BOARD EVALUATION

If directors go through the board evaluation process thinking that the only purpose of the exercise is to satisfy a formal requirement of their corporate law or listing rules, they are unlikely to be very impressed by what they end up with. A board evaluation process has a much better chance of leading to useful results if the directors relate the exercise to the challenges of the company, the role of the board in meeting these challenges, and to the reasons why they are themselves on that board. In other words, the purpose of a board evaluation process is to improve the quality of the collective decision-making, and actually ensure that better decisions are taken.

By definition, this is highly company and board-specific. While there are common steps and tools, in reality a good evaluation process, however conducted, is one that leads the board to contribute better to quality decisions. The implicit assumption is that is obtained by having better directors, better group behavior and better decision-making processes. The evaluation is an instrument, among others, used to achieve these goals.

STEPS AND TOOLS

Each company will have to test different methods and employ a variety of tools. They generally revolve around the following:

- Questionnaires: There are many “standard forms” (provided by institutes of Directors, search firms, etc.). They are all very similar, and can be a useful starting point, but they are never an end in itself. In addition, the board should refine the questionnaire over time to fit the needs of the company and the board itself. Specific questionnaires address the board, the committees, and each director individually.
- Frequency: Annual reviews are the norm, and are often mandated by the local rules. There is no good reason not to follow the norm, even though there will be times when the board feels that the exercise is not fully relevant.
- Third-party involvement: Boards that believed in assessments as a purely formal exercise have little motivation in seeking third-party assistance. In these cases, the company or board secretary handles the assessment internally. The reality is that there is limited down side, and many upsides, in asking an outside third-party (search firm, governance consultant, etc.) to assist in the board evaluation. The cost is generally limited, and the third-party introduces an element of objectivity and confidentiality that can only improve the quality of the comments made by interviews.
- Who leads the evaluation from the board? The answer can be one of the following: (1) the chair, (2) the head of the Nomination and Governance Committee (often the chairman himself), (3) the full Nomination and Governance Committee, (4) the “lead-director”. It would be unusual for the chairman or the “lead director” not to lead the exercise. Because of the need for confidentiality it is preferable to have one individual only handle the process from the board.
- Evaluation of each director: Whilst the evaluation of the board has now been accepted pretty much everywhere, there is still some resistance regarding the assessment of individual directors. However, this is where board evaluations are going. Companies

that are new to the process may indeed delay individual assessments, but they will inevitably have to get to both board and director evaluation.

- Role of the senior management: Many senior managements (in practice, those who are exposed to the board on a regular basis, CEO, CFO, etc.) are not involved in the board evaluation process. This is understandable, and even acceptable, where the process is still immature. However, companies that have been running good processes generally involve some of the top management and find the insights provided very useful (“360 degree” evaluation).

It takes a few years to get the process right, and the “culture” of evaluation to become engrained in the board and the rest of the organization. As everything in governance, board’s evaluation are a “journey”.

CONSEQUENCES OF THE EVALUATION

Probably as important as what is identified during the questionnaire and interview stages are the discussions that takes place and the action plans that are developed as a result.

This is often where the process fails, either because the results are never properly discussed, or because there is no effort to develop an “improvement” or a “progression” plan. The debate about board evaluation has moved from whether there should be one, to what to do about an evaluation once finalized.

The evaluation is not an end in itself. The findings may be interesting, but they are useless if the purpose of the exercise is not board and individual director progression – in the board’s composition, behavior, effectiveness, and generally its added-value in meeting the company’s challenges. For more information see “From Board Evaluation to Board Progression”.