

Who watches the watchers? Why an external board evaluation is most likely to result in a higher-performing board.

More and more boards are implementing formal board evaluation programs. In this issue of In Touch with the Board, the global Board Services Practice discusses the essential elements of a quality board evaluation and explains how the findings support the development of a high-performing board¹.

“Conduct of the evaluation of the board by an external third party can bring objectivity to the process, and the value of such an evaluation should be recognized by chairmen.”

—Higgs Report on Corporate Governance, 2003

Commitment to excellence

In the last decade, corporate boards have increasingly turned to board evaluation as a way to maximize their performance and to mitigate the blind spots that can unknowingly prevent them from fully executing their oversight responsibilities. This trend has accelerated as more countries have adopted corporate governance codes and regulations prescribing formal evaluations. As the global economy begins to emerge from a period of historic turbulence, companies also have sought to institutionalize the lessons learned from having unquestioned assumptions and limited perspectives in the boardroom.

It is important to note that an evaluation's conclusions are only as sound as the process is rigorous. A poorly constructed evaluation program can foster a false sense of security and actually can be counterproductive. An evaluation conducted by external advisors brings objectivity to the process and is recognized by stakeholders as a sign of commitment to excellence in corporate governance from the board.

The value of an independent perspective

In some organizations, the third-party approach to board evaluation has met with resistance. At many companies, the chairman considers evaluation as part of his or her personal remit as the board's leader, and, in many cases,

boards—for which confidentiality and collegiality are essential—are understandably wary of exposing their internal culture and decision making to outsiders.

Independent board evaluations provide essential insight into how the board functions as a group—a critical issue that sometimes is given insufficient weight in internal evaluations. High-performing individuals do not necessarily make for a high-performing board; it is how the personalities, competencies and experiences around the table interact with each other that determine the board's effectiveness. Furthermore, the length of director terms and the common practice of staggering director elections can cause the board's composition to lag behind the company's needs.

The perspective of outside consultants can be particularly helpful in the complex task of identifying the collective strengths and skills and examining them against the company's long-term business goals and the shifting competitive landscape so that the board can continue to be a strategic asset in its oversight and counsel to the CEO. Regular independent analysis of board composition and its collective effectiveness highlights competency gaps early on, and the nominating committee then is able to incorporate this insight in an ongoing way so that continuity and performance are not disrupted.

¹See *In Touch with the Board* series issue “What Makes for a High-Performing Board?”



At some companies, chairmen conduct board evaluations through an individual conversation with each director, in which the chairman both reviews that director's performance and solicits input on his or her performance and any other issues the director might wish to raise. From those collective conversations, the chairman determines areas where the board can be improved. But human nature makes it unlikely that particularly sensitive issues—exactly the ones that are the most important to address in a board evaluation—will get a full airing. Because the chairman so directly shapes board culture and practice, the feedback the chairman receives will be highly dependent on the relationship he or she has with each individual board member, which naturally will vary from director to director. Having independent specialists lead the evaluation process allows the findings and recommendations to be driven by the widest array of unfiltered input. In addition, when outside evaluators

report their findings, they do so in the aggregate, so that sensitive issues can be fully addressed.

Some boards that conduct their own evaluations incorporate this approach by using questionnaires that are gathered and aggregated by the board's chairman or secretary. While this increases the candor of the responses, it lacks the flexibility of an interview to probe key issues to extract nuance and detail.

Best practice

A third-party evaluation can take many forms, from detailed analysis and review of individual experience and competencies, to—in its fullest extent—a combination of customized questionnaires and in-depth individual interviews that will extract information from multiple perspectives and produce concrete, actionable recommendations. The interviews allow the evaluation team to explore complex interpersonal

Board composition evaluation process

- Meeting between evaluation team and chairman, chairman of the nominating committee and CEO to identify required experience and competencies—to ensure the board can provide effective governance and oversight
- Review and analysis of the experience and competencies of individual board members
- Presentation of report detailing overall competency match of board, as a group and as individual members; identification of potential areas of weakness
- Action plan to address requirements

Board evaluation process (in full)

- Meetings between evaluation team and the chairman, chairman of the nominating committee and the CEO to identify the required competencies to be represented on the board and particular issues to be probed
- Development and review of questionnaire to clarify the board's scope of responsibilities, procedures and governance, composition and team effectiveness
- Completion of (online or hardcopy) questionnaire by all board members
- Analysis of questionnaire responses by evaluation team
- Development of interview guide to focus on questionnaire responses warranting further investigation
- Individual interviews with all board members and senior management executives as appropriate
- Review and discuss with board all findings from evaluation and results from benchmarking
- Progress review after six and 12 months

Optional

- Self-assessment by individual directors
- Assessment of performance of other board directors
- Evaluation of the performance of individual committees

issues and often uncover unexpected and helpful findings. For example, it is not uncommon to learn that non-executive directors want to be pushed *harder* in their board responsibilities and to be given clear, substantial expectations—a discovery that surprises most chairmen.

What should a board considering an external evaluation expect? The first step usually is a meeting between the evaluation team and the chairman, nominating committee and CEO. This meeting will outline the general process and identify particular issues to be probed. The questionnaire then is developed, which typically covers clarity of the board's scope and responsibilities, its procedures and governance, board composition and team effectiveness, and is distributed to each director. After the questionnaires have been returned and analyzed, an interview guide is prepared that focuses on topics warranting further investigation.

Because many boardroom responsibilities—from succession planning to oversight of company strategy—depend on the board's relationship with management, the feedback of appropriate senior management executives should be incorporated into the input process. Board evaluations also should include self-assessments of individual directors; this component can be expanded so that directors are assessing each other's performance as well as that of the chairman and the board as a whole. The evaluation also can examine the composition, leadership and performance of key committees, such as nominating, audit and compensation, to provide a more complete analysis of essential board functions.

Benchmarking performance

After all input has been analyzed, the evaluation should include benchmarking. Even if an evaluation is thorough, its usefulness as a diagnostic is limited unless it is compared with accepted best practices. **Independent evaluators can compare the board evaluation findings with corporate governance standards and the practices of comparable organizations—an outside perspective that serves as an important reality check on the board's view of itself and provides the basis for concrete recommendations that the chairman can use as a road map to refine the board's procedures and elevate its performance.**

- If a board gives itself high marks for, say, risk evaluation, does that mean that the board, in fact, has the proper controls and information flow in

place and is asking the right questions of senior management—or merely that it thinks it does?

- Is the board's nominating committee casting as wide a net as it should be in identifying potential new directors with needed capabilities or is it overdependent on a narrow band of professional and personal networks?

While it generally is recommended that board evaluations occur annually, few boards use outside evaluators every year. The emerging practice is for external evaluations to be conducted every second or third year, with internal evaluations in the intervening years; outside evaluations act as guideposts the board can use to set direction while keeping the overall evaluation process sustainable. To generate the most value from the evaluation, the evaluation team should meet with the board and the nominating committee six and then 12 months after conclusion to review the implementation of the recommendations, progress on key issues and any complications that may have arisen.

Sensitivity and insight

Board evaluation always will be a highly sensitive issue. Any group evaluation involves a certain level of vulnerability and requires a combination of confidence and humility in those undergoing it. **The challenge for the group is to commit to a frank and insightful evaluation in order to generate actionable results.** Increasingly, boards are relying on the objectivity and expertise of external evaluation specialists to help them maximize their performance at a time when the expectations of boards by shareholders, regulators, employees and other stakeholders are greater than ever.

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