Board evaluation — addressing the 'so what?'

By Jane Bridge, Managing Partner, and David Band, Principal, Boardroom Partners

- Many boards and directors resist review because they have a narrow view of what a board evaluation might involve and achieve
- Preparing the board for a review with questions for consideration to focus their attention and ensure that the time and effort involved in a review actually pays dividends
- Boards' reactions to the review are at least as important as the process and the recommendations of the review itself

The case for *conducting* board reviews is now largely made. Increasingly prescriptive oversight by regulators has had a major impact on particular types of board (listed companies via the ASX Corporate Governance Council); industry sectors (finance and insurance via the Australian Prudential Regulation Authority) or employers (government sector boards via the various codes and policy frameworks in place at state and federal level).

In turn, these changed practices have influenced other sectors, and so reviews of board performance are now commonplace for many boards in not-for-profit organisations, industry bodies and some private companies.

This is a very different situation to 15 years ago when board reviews were uncommon, and tended to be clustered at opposite ends of the performance spectrum. We worked with boards then who were either strong and confident and looking for 'new and better ways' and confirming suitability of existing practices, or boards that were in deep trouble, rendered dysfunctional by composition, constitution or just plain confusion.

Trends and developments in board evaluation have emerged since this time, with many boards adopting a more formal approach to the process of review and some recognising the need to delve beyond the checklist approach of the 'right structure, size and composition'. Recent research found that these factors are not reliable indicators of performance and are of little relevance in predicting how effective a board will be.[1] Understanding what makes a board work well is now acknowledged as a more elusive, but more valuable, factor if a board is to be able to claim that it is doing more than acquitting its fiduciary duties.

Most directors we speak to report that they experience positive outcomes from evaluations. Again, recent research reinforces this view[2] and many other studies illustrate the range and variation in reviews.

So board evaluations — either conducted internally or (increasingly) with the assistance of external advisers — are now widespread and becoming more common. While some reviews are a result of pressure from regulatory bodies or investors, some boards already know that they are no different from other organisations — they cannot develop without feedback: 'No matter how good a board is, it's bound to get better if it's reviewed intelligently'.[3]

However, two caveats need to be noted in any 'progress report' on the state of board evaluation.

1. There is still some resistance to the whole concept of board reviews. Some directors regard evaluation as a waste of time and money, and will countenance the process only if 'pressured' by, for example, an industry regulator, major shareholders or board peers who have had a more valuable experience. *Pre-review* resistance can undermine the outcomes, success and validity of a review.

2. There is widely variable practice in terms of *post-review* behaviours. This includes:
   - seriously considering and discussing the recommendations arising out of the evaluation
   - agreeing a process and responsibility for implementing recommendations and
   - communicating externally the board's response to the evaluation.

Together, these two issues can be regarded as the 'so what?' of board evaluation. They reflect an approach to the review of boards — that evaluation is unnecessary, unimportant or simply another 'item to be completed'. This article examines these two factors, suggests reasons which we believe explain the thinking, identifies possible ways forward on each, and provides some up-to-date examples of good and not-so-good practice from reviews we have undertaken in the past six months.

In recent years, Boardroom Partners has conducted almost 100 board evaluations. These have ranged across all sectors and have covered organisations of widely differing sizes. We have seen many changes in this whole area, including a generally more positive and sophisticated approach to board evaluation. We continue to develop and monitor approaches in board review methodology, and this article draws on some of our most recent work conducting board evaluations, using two quite different reviews as case studies. Successful reviews have a number of common features and those that produce more limited results for a board similarly have some consistent themes. As a guide to successful reviews, we have assessed all of our 2011 reviews of client boards to distil principles that we hope are valuable to company secretaries and others charged with considering and administering a board evaluation.

Board evaluation — conformance and performance

In our experience, resistance to board evaluations is often connected with a relatively limited view of what a 'board evaluation' might involve.

One of the most frequently used frameworks for analysing board activities and functions is set out in Figure 1. First elaborated by Fred Hilmer,[4] it has consistently proven its effectiveness and usefulness for board members. This framework clearly illustrates the competing demands upon boards of directors to:

- balance conformance and performance
- monitor the present while preparing for the future
- provide oversight and
- set direction and approve strategy.

Figure 1: Framework for analysing board roles

	Conformance	Performance
External	**Accountability** Reporting to shareholders Ensuring statutory/regulatory compliance Reviewing audit reports	**Strategic thinking** Reviewing and initiating strategic analysis Formulating strategy Setting corporate direction
	Appointing and rewarding	
Internal	**Supervision** Reviewing key executive performance Reviewing business results Monitoring budgetary control and corrective actions	**Corporate policy** Approving budgets Determining compensation policy for senior executives Creating corporate culture
	Short-term	Long-term

The framework is a reminder of the multidimensional roles and responsibilities of boards and directors and of the need to avoid placing the entire emphasis on single functions or responsibilities. In our experience, there is a tendency for externally driven evaluations — especially those required by regulators — to emphasise conformance. We have considerable sympathy for boards that are subject to this approach, and understand their antipathy to the whole idea of board reviews. Placing too much focus on conformance can call into question the return on investment for board evaluations.

Checklists and boilerplate questionnaires can be a useful 'starter' for a board with no experience in review or self-reflection; however, it is unlikely that a standard 'set of questions' would draw out anything that board members did not already know about themselves. While the existence of charters and the composition of committees can be matters for check box response, any value derived from these mechanisms will be from their actions and behaviours, not simply their existence.

Certainly, we note a dwindling satisfaction with questionnaires and 'tick and flick' evaluations these days. Amusingly described by a director on a current client board as 'about as much use as half a pair of scissors' these non-threatening tools can provide a useful entry to the discipline of review and allow for a public declaration of having completed a review. However, in our experience, most boards conclude either that this approach is deficient, or that reviews, per se, are a waste of time.

The most profound question boards face is whether they can carry out their fundamental tasks of accountability and value creation — which often seem to compete — with any degree of effectiveness and consistency. Boards fulfil a vital role, covering both an outward-looking function of accountability to the stakeholders and strategy formulation, and an inward-looking function of monitoring, control and setting policy.

Clearly, the board needs to balance the strategy and accountability elements of its responsibilities in ways that encourage performance while maintaining effective control. An overemphasis on monitoring can lead to non-executive directors being perceived as mere policemen by the executives, setting up problematic divisions within the board and driving out trust. An overemphasis on strategy can lead the board to overlook critical aspects of compliance that have potential for major damage. Directors can effectively address this challenge of simultaneously exercising monitoring control and driving energetic strategic initiatives by working to their collective potential as a team, with the full engagement of all members.

Critically, an evaluation can enable the board to recognise both straightforward and complex issues and bring them to the surface for resolution. It also sets the tone for a continuous improvement culture within the organisation. It is difficult to drive such a culture from board level if the board itself is evaluated largely on how well it conforms to a set of procedural requirements.

We find that the most common reasons for board evaluation are to:

- identify areas for improvement either in a general or specific way
- model the required rigour around performance management for the executive, management and all employees in the organisation
- demonstrate to stakeholders the attention paid to governance and to disclosure
- comply with requirements of any relevant regulatory regimes

- offer some protection for directors to reaffirm commitment to and acquittal of the role.

To meet these goals, it is necessary to use a value-adding blend of performance and conformance prisms, rather than a too-heavy (and often value-extracting) focus on the degree to which the board has ticked various conformance boxes.

> 'At one board I sat on, they did an external evaluation every three years, using consultants, who criticised the length of the meetings (4+ hours), the presentations, the detail. Nothing changed. But I suppose it doesn't do any harm.'
>
> One chairman describing the low ROI board evaluation

The high-performance board

What is the latest thinking and evidence on the core elements of an effective board? In summary, both academic research and Boardroom Partners' practical experience confirm that high performing boards are those that have:

- a clear and appropriate delineation of roles
- an effective combination of the monitoring and control functions with strategy
- strong independence from, and an effective working relationship with, management
- a continuous focus on having the appropriate mix of skills, experience and backgrounds to help deliver on the organisation's strategic objectives
- a culture of challenging and questioning each other, while maintaining a good working relationship as a team
- robust operational procedures aimed at enabling directors to focus on their key responsibilities and
- a commitment to evaluating their performance.

A question often asked by 'review-sceptics' is 'So what? How does all this relate to corporate performance?' The link between board performance and corporate performance can be difficult to establish because of the complexity of governance and the multitude of external and internal factors that can affect performance. Nevertheless, there is increasing support for the proposition that such a link exists.

First, there is growing research evidence that major investors do have close regard to the governance practices of companies in which they invest. Second, there is evidence of out-performance of funds in which investment decisions have had a strong regard to governance. The third source of support for the relation between governance and performance is quantitative research. A number of studies have found that such a link does indeed exist.[5]

Capability — the 'softer' part of board performance

In many recent efforts to 'reform' boards, great attention has been paid to their size, composition and structure as the basis for achieving better boards. Such an approach, while it focuses on the mechanical aspects of governance, can have only a limited impact on board performance and can therefore result in disappointment. The danger is of overlooking the importance of the board's essential value-adding responsibilities.

> Board structure and composition condition but cannot determine board *effectiveness*. Instead, board effectiveness depends upon the experience, skill and judgment of individual executive and non-executive directors and the ways in which these are combined to shape board conduct and relationships.[6]
> [emphasis added]

Increasingly, there is attention to developing an appropriate skill set on the board, with a mix of experience and competencies. Governance literature suggests non-executive directors require both functional and organisation-specific knowledge and skills. In our experience, boards tend to focus on functional competence (for example, a financial background or marketing experience) and less on the more generic skills (for example, strategic capability) that are also vital.

The one element that is absolutely essential in the armoury of directors and boards is judgment, which reflects both in-depth knowledge and independence. 'Judgment' cannot be legislated for and cannot be created through mechanistic 'reforms'. Independence is not guaranteed by insisting on a particular board composition. It needs to be built into the mindset and culture of the group.

Lastly, no matter how skilled and sound individual directors are, a high-performing board also needs to operate as an effective team. There is little research on the melding processes that take place during board meetings to contribute to effective corporate outcomes, although this is increasingly acknowledged by the boards with which we work as a distinguishing factor that separates merely competent boards from great ones.

Characteristics of an effective 'performance' board

In our experience, board members sometimes believe that their board is operating effectively if directors assiduously go through their papers, are present at virtually all meetings, and go about their duties in a diligent and industrious manner. If this is all they do, such directors are carrying out their conformance responsibilities. They are not maximising their potential contribution to the performance of the organisation. As a consequence, the organisation and its stakeholders suffer.

A truly effective board focuses at least as much on its performance responsibilities as its conformance obligations. As identified by Clarke and Klettner in their research for the Australian Council of Superannuation Investors and reported in this journal, there are a number of distinguishing features of 'effectively performing boards' and those who are 'dysfunctional'.[7] Our experience leads us to similar conclusions and we suggest that a high performing board exhibits all, or a great many of, the identifiable characteristics that it is possible to assess and calibrate.

In summary, the highly effective boards with whom we work, are fully aware of the need to achieve excellence in both conformance and performance. They maintain an ongoing dialogue at the board table on precisely this balance, and it is the focus of the more formal annual board review. Moreover, these boards seek to *remain* effective by giving strategic and continuous attention to their own human capital requirements: the future skills they will require and the agreed means of acquiring them, either through succession or development or both. In their governance practice, they ensure that procedures and protocols are aligned, optimise the use of those skills and support the efficient delivery of the board's business.

The one element that is absolutely essential in the armoury of directors and boards is judgment, which reflects both in-depth knowledge and independence. 'Judgment' cannot be legislated for and cannot be created through mechanistic 'reforms'.

After the review — so what?

The other 'so what?' element of board evaluations can be seen in the way in which some boards react to the findings of a review. A thorough review of a board's effectiveness on both the performance and conformance dimensions will produce a number of recommendations. This is true for even the best-functioning and most effective of boards. The board is then faced with a choice of behaviours on:

- how seriously it addresses those recommendations
- the 'tightness' of its implementation of the recommendations that it adopts and
- how it communicates to relevant stakeholders its response to the recommendations.

In our review work with boards, we see a wide range of responses to these three issues. The nature of the response tends to vary according to the extent to which the review is a voluntary exercise requested by the board, or a statutory or regulatory requirement of the board. It is easiest to illustrate this by reference to two actual cases, which we have, of course, de-identified for this article.

Board A

This is the international advisory board of a major multinational corporation. This is not the company's board of directors, but a group of international stakeholders and senior company executives, set up to advise the company on strategic and potentially sensitive issues relevant to the company's business. The board is now in its second decade, and has seen some refinement of its purpose and considerable changes in its membership.

Boardroom Partners has now worked with the board on two reviews. The first produced 29 recommendations, 27 of which were wholly or partially adopted. When we commenced work on the second review, it was apparent that the board and the company had taken a serious, even forensic, approach to the consideration of those recommendations. Each had been carefully considered; the board's secretariat was given a clear brief to manage the implementation of those recommendations; and all board members, including those who came onto the board after this review, were kept informed of implementation progress and outcomes.

One key outcome of the first review was that the position of board chair was subsequently filled by a very senior executive member of the corporation. This was the clearest possible sign of the company's commitment to the advisory board and the seriousness with which it took its advice.

The second review occurred two years after the first. Like the first, it encompassed both an evaluation of the board as a whole and peer and self-evaluations. Among its key findings were that there was:

- greater clarity about the board's role and responsibilities
- an increased level of satisfaction with the board's effectiveness
- agreement on the additional value generated by implementation of first review's recommendations
- a shared desire to learn from self-assessments and those of others and
- a more exacting standard of performance set for the board and individuals by board members.

This review also produced a number of recommendations. These were fewer in number than for the first review; reflected a more sophisticated and demanding approach to the board's work by its members; and were at least as much focused on how best to add value in the future as on fixing perceived current issues. As with the first review, this evaluation covered both the board as a whole and individual self- and peer evaluations. Unlike the first review, no major problem areas were identified.

At the board meeting which formally considered this review's findings, the chair made it clear that, although the board members all regarded the review as an extremely worthwhile exercise and its recommendations as highly valid, the review would add lasting value only if the board and the company took a disciplined approach to implementing those recommendations. At that same meeting, the chair immediately implemented those recommendations that related to his role.

Thus we have now twice had the opportunity to observe how this particular board addresses the 'so what?' issues. Because it has been so thorough in its response to both evaluations, board members and the company can see significant benefits from a review process. This board is an exemplar of the fact that merely carrying out an evaluation is never enough: added value and performance-lift comes from a commitment to consider seriously, and where appropriate implement, the evaluation's findings.

Board B

This is the board of an organisation that provides professional services to an industry. It is subject to a regulatory authority, which requires all boards under its umbrella to engage in regular evaluations. To date, this board has reviewed itself using a set of standard questions and this year has been advised by the regulator that an external review is required.

Boardroom Partners was asked to facilitate that evaluation. In line with our usual practice, the review focused on both the conformance and the performance dimensions of the board's workings. It also incorporated both a survey common to all board members and interviews with each of the individual directors.

The review's findings were largely positive, and included:

- agreement on how the board can and does add value to the organisation
- a tightly run set of board operations
- a knowledgeable and effective chair
- a good and trusting relationship with senior management and
- universal agreement that board membership is a positive experience for all.

Table 1: Review of the review

Issue	Board A	Board B
How seriously the board addresses those recommendations	• Chair and CEO discussed recommendations • Report distributed for pre-reading • Time allocated on agenda • Discussion recorded and responsibilities allocated • Commitment made to repeat the process in 2 years	• An agenda item ('Noted')
The 'tightness' of the board's implementation of the recommendations that it adopts	• 12-month plan developed • Report back at each meeting in the meantime	• No agreed process considered for implementation • Recommendations from previous (internal) review remain outstanding • No advice on any follow up
How the board communicates to relevant stakeholders its response to the recommendations	• On website • Will be included in the annual report	• Unknown, although regulator may request a copy

There were also a number of findings that highlighted areas for improvement; some of these were material while others were of a less substantive nature. The response to the findings was defensive and disbelieving of the findings; 'evidence' was called for and redrafting of many parts of the report was requested.

Contact with the board members was all channelled through the capable (though dominant) chair and the review period ran for almost five months. No external parties were involved and few members had any prior experience with performance review. Background information was hard to extract and there was no briefing or meeting with the board as a group. A number of drafts were required to arrive at 'suitable language'; it was clear that a number of recommendations would not be implemented or perhaps not discussed.

This board is a good example of undertaking a review without commitment or consideration of what might be the outcome and putting in place a mechanism to respond to what can only ever be recommendations for change.

Table 1 encapsulates how did each of these boards fare under the 'so what?' issues.

Jeffrey Sonnenfeld's words are worth repeating here: 'No matter how good a board is, it's bound to get better if it's reviewed intelligently'.[8] To which might be added: ' … and if an intelligent review is responded to intelligently'.
For company secretaries, it may be worth preparing the board for a review with some 'questions for consideration' to ensure that the time and effort involved in a review actually pays dividends and leads to improved performance.

We suggest the following list as a starting point.

- *What* would be an acceptable outcome from this review? (And what could we not accept?)
- *How* would we deal with any recommendations? Who would be responsible? Are we willing to put in extra time if that was required? Where does it fit in the overall cycle or calendar for the board? Would we consider doing anything differently if that was recommended?
- *When* might we do this again? And what do we expect could we carry forward? Or do we have previous results that could be made available as an input this year?
- *Where* would we want to publish or broadcast any outcomes? (The annual report? A shareholders' meeting? Advice to a Minister? Notice to members? Information for donors?)

So, while not compromising the outcome of the review, it is possible to define the parameters of a review and work with the board to agree the rationale and expectations of a review, rather than undertaking 'any old thing' so that the requirement can be struck off the agenda for another 12 months.

Finally, the following *principles* have been distilled from our work with good, bad and indifferent boards, who have commissioned good, bad and indifferent reviews. We suggest they underpin a quality board review, and are offered by way of advice for boards wanting to avoid the 'so what ?'

Another chairman said 'Evaluation has changed how we operate. You pick out four or five of the most important things and then commit to having a discussion in the future about whether they happened. For instance, are NEDs making more consistent contributions around the table?; Are communications from the executive are more open and timely?'

Agree on the rationale for a review

What is driving the review? Why is the board doing this? Are all directors aligned with the need for a review? Is this review only about compliance? Is it about paying lip service to the concept? Does it deal with a pressing problem? Is it about discovering what other boards are doing?

Transparency

Be prepared to provide background information and include access to relevant documents and stakeholders. Waiting for an adviser to discover issues when they are already well known internally is time-wasting and sets the wrong tone for a review where trust is important.

Responsibilities for execution are clear

The company secretary may have a key role, may only be an administrator or may be excluded entirely. Some boards delegate a review to a committee; others involve a single director as 'point person'. Whatever the approach, it is important that all directors understand what is going on and what is expected of them.

Identification (and inclusion) of key parties

Many board reviews include management and other key stakeholders that are external to the board. While a first review may be limited to 'members only', the board needs to consider who might have a valid and informed view about board operations, membership and performance and include them in the process.

Unanimity about the chosen model

Ensure that that all who are to be involved are willing and able. There's no point in having a sophisticated online survey to collect information if some directors won't use a computer! Similarly, there's no point designing a model that has face-to-face interviews at its core if key directors are out of the country over the review period.

Participants are able to meet

Boards need time and a forum to discuss and debate findings from a review. When a review is tightly controlled and led by one or two individuals, limiting access to others will preclude full engagement and reduce the potential for adding value through change.

Consideration of implications associated with recommendations

This is a new concept for many boards used to delegating, supervising and monitoring. Many recommendations arising from a review relate to the board itself; changes are not always items that can be attended to by the company secretary. For some boards, this requires redesigning or augmenting committee structures and responsibilities so as to have a dedicated resource for driving and monitoring improvement.

Approach to future reviews

While listed companies must now report on review activities, a full-scale review, perhaps involving an external facilitator, is not usually warranted annually. Identifying and working with some critical indicators of performance is an efficient approach and will allow for a board to 'do it themselves' or change facilitators without losing any valuable data that may be available from previous reviews.

Building in some time for discussion and debate around a board review is time well invested. If a board approaches a review as simply another item on its calendar, it may well conclude 'So what?' at the end of the process. However, if a board is interested in learning about how things might be different, how others are operating or how to deal with their responsibilities in another way, put time aside to prepare.

Preparation requires consideration by the board about what might happen when the review is complete; what the most suitable approach might be for the board in question; agreement about participation; allocating resources to ensure the review runs smoothly; and agreeing a process to ensure that implementation occurs and adds real value to the business of the board.

All of the above are more likely to lead to a 'so that was useful/interesting/ helpful' and a platform on which to build the capacity of the board for the next few years. Focusing on compliance and reporting in a review will provide some solace for some directors, for some of the time. In the longer term however, such an approach is more likely to lead to the 'So what?' conclusion.

Jane Bridge and David Band can be contacted on (02) 9241 6311 or by email at jane@boardroompartners.com.au or research@boardroompartners.com.au.

Notes

1 Tricker RI, 2009, *Corporate Governance — principles, policies and practices*, Oxford University Press
2 See Klettner A and Clarke T, 2011, Board evaluation post-financial crisis', *Keeping good companies*, Vol 63 No 4, pp 200–206
3 Sonnenfeld JA, 2002, 'What Makes Great Boards Great', *Harvard Business Review*, Vol 80 No 9, pp 106–113
4 Hilmer F, 1998, *Strictly Boardroom — Improving Governance to Enhance Company Performance*, BRU Business Books
5 Gompers P, Ishii J and Metrick A, 2003, 'Corporate Governance and Equity Prices', *Quarterly Journal of Economics*, Vol 118 No 1, pp 107–155
6 Corley KG, 2005, 'Examining the Non-Executive Director's Role from a Non-Agency Theory Perspective: Implications Arising from the Higgs Report', *British Journal of Management,* Vol 16, Issue Supplement s1, pp S1–S4
7 Klettner and Clarke, op cit
8 op cit