BOARD EVALUATION
A TOOL FOR CHAIRMEN

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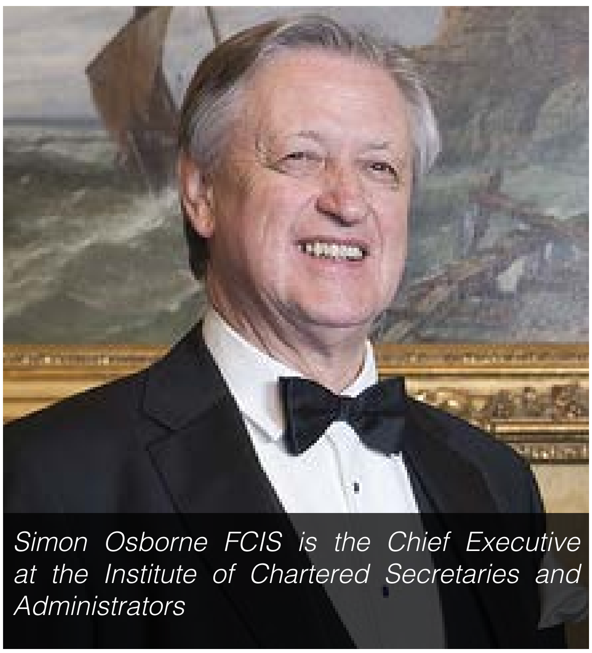
In the UK, the requirement for regular formal evaluation of board performance was introduced in the 2003 Combined Code – the UK's then Corporate Governance Code - which followed the 2002 review into non-executive directors by the late Sir Derek Higgs . The Higgs Guidance intended the evaluation to be used as 'a mechanism to improve board effectiveness, maximise strengths and tackle weaknesses'.

Initially, take up by listed companies in the UK was fairly slow. For the most part, boards which chose to undertake an effectiveness evaluation did so as an internal exercise or sometimes used a favoured executive search firm. The rigour and independence of these reviews are clearly open to question.

It was not until the Combined Code, reissued in May 2010 as the UK Corporate Governance Code following the recommendations of the 2009 Walker Review, that the requirements on board evaluation were tightened. The new Code included a specific provision that every board should carry out a 'formal and rigorous evaluation of its own performance and that of its committees and individual directors' one of which was to be externally facilitated at least every three years.



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The chairman, supported by the company secretary, has responsibility for the process of board evaluation, and for acting on the results. The outcome of the evaluation should be shared with the whole board and the results should influence, as appropriate, the future operation, development and composition of the board. FRC Guidance also suggests that the company has a review loop to consider how effective the board evaluation has been. Along with other governance processes, the board evaluation process and approach should be reviewed periodically to check they are fit for purpose and how they might be strengthened or improved.

Internal or external evaluation?

Whether facilitated externally or internally, evaluations should explore how effectively the board works as a unit, as well the contributions of individual directors. Performance evaluation is particularly important for non-executive directors (NEDs) who, in contrast to executive directors who commit most or all of their time to the company, may hold multiple directorships, and spend only part of their time with the company, even though they make up membership of the key board committees.

While internal evaluation has a place, it is not without risks and it might be argued that the use of a questionnaire alone may not satisfy the requirements of the Main Principle B.6 of the 2014 UK Corporate Governance Code regarding rigour. Questionnaires devised in-house can have a tendency to miss some of the key issues and sometimes they get stale and predictable. As the chief executive of one client once remarked to me the problem with his board's questionnaire was that not only did he know the questions, he knew what answers he would be giving!

An internally-driven evaluation process is not inherently bad, any more than an externally-provided service is inherently good. There are some genuinely rigorous internal processes. It is the sensibly blended use of both approaches which seems to offer a happy medium for many boards.

However, in our experience when it comes to evaluation of individual director performance, most boards still prefer internal evaluation. This relies on the chairman to undertake the review and to provide feedback to each director in a one-on-one discussion. This is fine providing the chairman has the experience and fortitude for the task - which can be challenging.

The value of external facilitation lies, of course, in the objectivity and new ways of thinking which third parties can bring. An external facilitator may raise an issue that one or two board members have been aware of but have been reluctant to speak about to avoid upsetting the status quo. As the FRC Board Effectiveness Guidance points out, there are certain circumstances when external evaluation can be particularly useful – such as where there has been a change of chairman, or there is an external perception that the board is, or has been, ineffective.

ICSA's experience as an external facilitator suggests that generally companies embarking on an externally-facilitated evaluation for the first time prefer to confine the evaluation just to the board. It is much less challenging emotionally for a whole board to be evaluated. We believe that evaluation has to be proportionate and for that reason that we offer separate processes to evaluate the board, the main board committees and individual directors.

ICSA takes a personal and confidential approach in the form of a structured conversation with each director. This encourages the director to be totally frank and open without committing a view to paper. It also allows for additional explanation if the director is unsure about the question being asked and the evaluator is able to probe further when a response merits deeper discussion.

How board evaluation can assist the chairman

A well conducted board evaluation report will provide the chairman with insight by commenting on:

• The balance of skills and experience on the board

The chairman should be reassured that there is a good balance of skills, experience and diversity on the board and if the results show otherwise, the gaps should be identified together with the attributes required in any new director(s). This is essential for good succession planning (see below).

• Gaps and concerns

Gaps between strategic priorities and delivery and any other inadequacies in the way in which the board discharges its responsibilities should be identified. The quality of the board's discussions about risk should be commented on as well the effectiveness of risk management processes at board committee level. Another key area to cover is the quality of the governance of subsidiaries and the robustness of the internal control regime.

• Key relationships

The chairman will find out whether key relationships really work e.g. the chairman and the chief executive, the chief executive and the board, executives and non-executives and where the stresses are.

• Succession planning

The report should comment on the way in which the board discharges its responsibilities for succession planning or 'refreshment'. It is not just a case of the nomination committee, together with the chairman, reviewing the composition of the board and the tenure of individual NEDs. Succession planning also concerns the executives and the chairman and the board needs to take an interest in the way in which the chief executive discharges this key responsibility of building and nurturing the talent pool.

• How the board functions

The chairman needs to know too whether directors are content with board practices and procedures, the timeliness of board meetings, the planning of the forward agenda and the relevance and objectivity of information. Related to that is the need for assurance that the company secretary is performing and that the secretariat is providing the board with service and support of a high quality. The report will include reports on the effectiveness of board committees and how they are connected with the main board.

Reporting on the evaluation

The detail with which boards report on the board evaluation process in their annual reports should be reviewed too. I suggest five key points which boards should try to address in their coverage:

1. what has been reviewed (board, committees, directors) with an explanation if, say, only the board was being reviewed

2. who conducted the evaluation and an explanation of how any conflicts of interest were managed or disregarded

3. an outline of the nature of the process

4. an outline of key findings, lessons learned, and

5. follow up actions agreed by the board

What should chairmen look for?

From experience of evaluating boards over the last decade here are some pointers for chairmen to keep in their sights:

The board and board committees

• More attention needs to be paid by the board as distinct from, say, the audit or the risk committee to risk identification of management and business continuity.

• The quality of the board's discussions about risk needs to be addressed

• There seems to be insufficient discussion of social media policies and cyber risk.

• The nominations committee is not always fully engaged with regard to succession planning and the committee's thinking is sometimes at odds with the view of other members of the board.

• Audit committees in some companies are being overworked.

• More attention needs to be paid to the quality of subsidiary governance.

The people

• The level of interaction between the executive and non-executive and between the non-executives and the "marzipan layer" is sometimes less than optimal. Some directors are still not really keeping up to date.

• Often the strategy day is poorly planned with too much information being imparted and insufficient 'air time' being built in for the non-executive directors.

Finally, for the company to get the best out of board evaluation and to use the results constructively, everyone involved, chairmen included, needs to guard against their own sensitivities and prejudices. Effective board evaluation is rooted in the underlying principles of all good governance - accountability and transparency – and as often quoted, an effective boardshould not necessarily be a comfortable place. Challenge as well as teamwork, says the FRC, is an essential feature.

As the Preface to the current UK Code points out:

'To run a corporate board successfully should not be underrated. Constraints on time and knowledge combine with the need to maintain mutual respect and openness between a cast of strong, able and busy directors dealing with each other across the different demands of executive and non-executive roles. To achieve good governance requires continuing and high quality effort'.