Director Evaluation: Who Watches the Watchers?

By

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The age-old question lingers: Quis custodiet ipsos custodies? Who watches the watchers? In theory, shareholders, business owners, and CEOs scrutinize the actions of board directors, but the facts tell a different story. In spite of the New York Stock Exchange now requiring regular self-evaluations, many boards continue to function without them—or without doing them well. Boards that want to act as strategic assets and sources of competitive advantage have to do better. They need to hold themselves accountable and establish a rigorous process to benchmark their performance—not just the collective performance of the board, but also the contributions of each individual director.

The benefit of director evaluation seems clear—having standards of performance measurement for the board. Without this kind of yardstick, directors cannot assess their own successes and failures, measure how well they are meeting their fiduciary responsibilities, or hold themselves accountable for delivering the value others expect of them.

Research tells us that people pay attention to what others measure—not matter how much lip service they give other considerations. Further, feedback about agreed-upon objectives is one of the surest ways to change behavior—or at least to encourage the change. When people don't know *exactly* what they need to improve, how likely is the improvement? On the other hand, most directors agree to serve on boards because they are well-intended and committed, but they lack the concrete, specific information that would help them leverage their strengths and mitigate their weaknesses. When they have the salient information, they can begin to do better.

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Getting Started

To begin an evaluation of directors, start with the criteria against they will be evaluated. These criteria should reflect the overall mission of the organization, the long-term vision, and the shorter-term strategic objectives. For instance, if a manufacturing company wanted to position itself for substantial organic and acquisitive growth, the directors who serve should have some experience in one of these areas. If this same company also happens to be publicly traded, some of the directors should understand the regulations and compliance issues the company will face as it expands. Therefore, these specific competencies / experiences should be part of the evaluation.

Some general criteria should appear in every evaluation—for instance, the ability to read financial statements. Similarly, all directors should demonstrate strong critical thinking abilities, effective communication skills, and a commitment to preparing for and participating in scheduled meetings.

Once the CEO and directors agree on the criteria, the next step is to define the process. Gathering data in a way that minimizes defensive reactions but also captures accurate information can present a challenge. The board chair, or someone who volunteers to act as the coordinator, can develop the survey, provide the form for all the participants, collect the surveys, and do the math. The problem lies in the "Now what?" question.

Obviously, participants will be eager to know their results—and more than a little anxious about how their fellow directors have rated them. Sensitivity and confidentiality must reign. One option is for the coordinator to schedule a time for each individual to view his or her results in private. But that doesn't address the person's own "Now what?" question. In other

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words, once I know that people have identified a weakness, I may want to change but lack the insight about what I should do and how I should do it.

That's why having an outside consultant oversee the process makes sense. This consultant should be someone who can both manage the process of data gathering and give constructive, developmental feedback to individual directors. (These consultants need not be psychologists, but they should have a proven track record for engendering dramatic results through coaching). Then, based on the feedback directors receive, they can then formulate an action plan that they will share with the other members of the board.

Data Gathering

When conducting an evaluation of a CEO, I usually use interviews instead of a survey. This gives me the chance to ferret out issues and hear expanded explanations from directors about the CEO's strengths, the ways to leverage them, and the things that seem to block progress. When conducting evaluations of directors, however, I often find a survey a better tool for identifying the specific skills, behaviors, and experiences we want to assess. Follow-up interviews can then make sense of the quantitative data.

The following survey is one that I developed for a $100M manufacturing company that aspired to double its revenue in the next five years. The current board had overseen the company's significant growth, but the CEO wanted to understand whether he had the right people in place to attain his aggressive growth strategy. Therefore, I asked him to rate each director on a scale 1-10, with 1 indicating low expertise or experience. We then had a foundation for asking the rest of the directors to assess themselves and each other.

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	Smith	Jones	Davis	Carpenter	**Competency Totals**
Ability to read financial statements	5	10	3	8	26
Communication skills	10	3	8	5	26
Experience with acquisitions	3	8	1	8	20
Knowledge of compliance	4	7	4	7	22
Ability to assess risk	5	9	3	9	26
Track record for aggressive growth	7	6	7	6	26
Knowledge of operations	10	6	9	7	32
Industry knowledge	9	8	8	7	32
Critical thinking skills *	6	9	6	8	29
Participation in & preparation for meetings	10	4	7	5	26
Individual Totals	69	70	56	70	

*Gets to the core of issues. Thinks dispassionately. Sees patterns and contradictions. Prioritizes effectively.

Interpreting Results

The information on this survey is pretty straightforward. The evaluator has the chance to see instantly how an individual director stacks up vis-à-vis the other directors and how well collectively the board represents specific competencies.

In this case, Davis, the overall weakest director, offers strong operational and industry knowledge, but so do most of the other directors. People find him easy to work with and responsive to the board's needs, but he lacks some of the basics, like strong critical thinking abilities, and some of the specialized needs of this board, like experience with acquisitions—

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which is an overall weakness for this board. The CEO needs to consider replacing Davis with someone who has more experience with acquisitions.

Contrast Davis to Jones, who boasts one of the highest scores. Jones seems to lack strong interpersonal skills and doesn't appear to participate at the same level that the others do. Yet, he demonstrates a superior knowledge of general finance and the exact skills this board needs related to risk assessment and acquisitions, two of the lesser represented competencies overall. Unless his interpersonal skills are tragic, and he doesn't respond to feedback about his behavior, I recommend keeping him on the board. (The good news for someone like Jones is that he has 100% of the power to change his weaknesses—unlike Davis who either can't change his critical thinking abilities or who would take an inordinate amount of time to acquire the requisite skills and experience he lacks).

This board relies too heavily on Jones and Carpenter for financial acumen, risk assessment, and experience with acquisitions. The loss of either could spell trouble—particularly if the loss happened unexpectedly. In the short run, this board should identify external consultants who could help in an emergency and begin recruitment of Davis' replacement. In the long run, the board should map out a succession plan for the board in general and each director in particular.

Conclusion

Each year new regulations surface to protect consumers and hold boards and executives accountable to shareholders. Corporate governance is on the move. Meltdowns and regulations cause change, but some things remain the same: We have come to demand more of our

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executives and directors. No longer can either group languish in a role and expect to keep it for life—not even in privately-held companies.

Active, compliant boards and executives no longer offer organizations enough. Companies need and demand stellar performance from both individual directors and the board as a whole. A volatile economy has shown us not to rest on our laurels too long or we won't have any glory to rest on.

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