Board Evaluations: Improving Effectiveness

By

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In parts of Indonesia Komodo Dragons make unwelcome and unannounced visits to villages that border their habitat. Even though the giant lizards and humans lived in harmony for generations, contention exists now. Environmentalists have imposed new policies in a region where people perceived a sacred duty in caring for the Komodo Dragons. The relationship between lizard and human has not been the same since.

Executives and boards of directors have experienced a similar loss of symbiosis. The Sarbanes-Oxley Act of 2002 and The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 have caused executives, especially CEOs, and directors to examine the way they do business. Now, more than ever, directors are taking their responsibilities seriously, speaking up, and striving for results; but in many cases, the evolving relationship between the company's executives and the board has not found the right symmetry. Finding it will depend on several factors: identifying success indicators for the board, committing to annual evaluations, and making the tough requisite decisions to move your board from compliant to stellar.

Why Conduct Evaluations?

Does your board perform or simply comply? Too many boards monitor the details of compliance almost to the exclusion of paying attention to the future of the organization. In other words, while you're dealing with the tactical issues, you may be ignoring the strategic role of the board and spending too little time on proactive work.

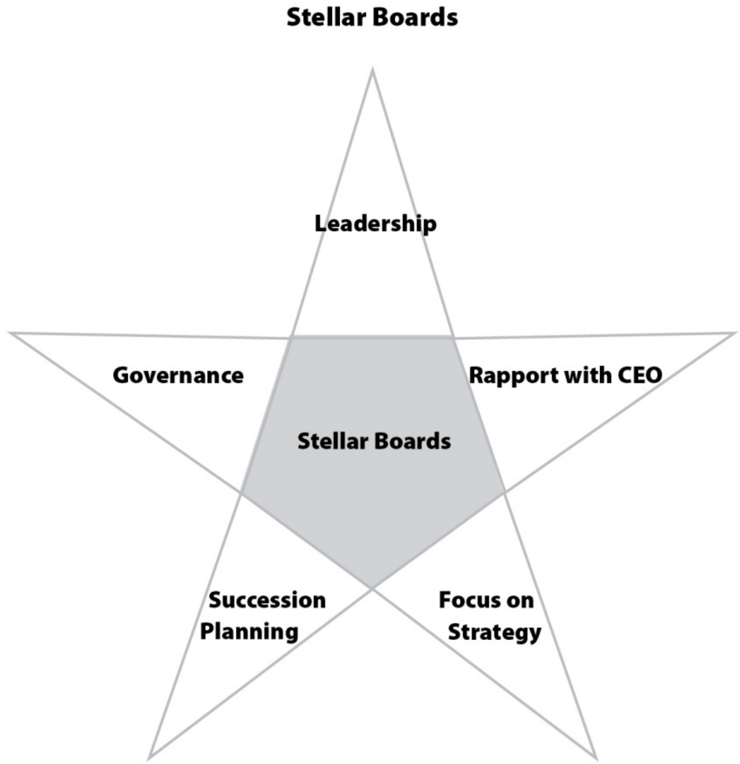
Many directors recognize that just as past practices have failed them, recent attempts to improve have not always succeeded either. To recruit new directors and quell shareholder unrest, directors need to understand their roles better, and to go beyond activity and conformity to goal realization. In addition to complying with the New York Stock Exchange rule that indicates “The board should conduct a self-evaluation at least annually to determine whether it and its committees are functioning effectively,” directors cite the following reasons for evaluating themselves:

- To coordinate efforts among board members, especially members of the search committee, when the CEO needs to be replaced or board seats are vacated
- To work with the CEO to set strategies
- To oversee the process of directors giving developmental feedback to the CEO
- To learn ways to promote high professional standards for director performance
- To make decisions about director succession planning
- To improve communication with the CEO, media, educators, and investors

The benefits of self-evaluation are apparent and immediate. The company can save millions of dollars by taking the guesswork out of CEO selection; directors can realize their full potential both collectively and individually when they understand what should change; and the board can operate at an exceptional level when it keeps its focus on the strategy of the company—all characteristics of the stellar board.

Setting Criteria: The Stellar Board

We evaluate better when we have a standard against which to compare. Whether you’re creating an advisory board or working with a board of a privately held or publicly-traded company, the real challenge for directors and executives isn’t regulatory compliance—it’s stellar performance. To achieve it, directors and executives should systematically examine the five constructs of a successful, high-performance board:



Leadership

Too often directors assume the role of sponges who simply absorb that which sits in front of them. Part of the directors' leadership duties requires them to think independently and to prepare questions that will stimulate dialogue. If the data remain in directors' heads, what good is it? Therefore, each director has the obligation to guide the process of making the implicit explicit—of making knowledge pragmatic advice, but they can't do this unless they receive the meeting agenda and related materials in time to review them prior to the meeting.

Meeting discussions should uncover all kinds of differing points of view, but ultimately the board needs to ask itself, “So what?” What will directors support, if the decision is theirs? And how will executives use the insights they have gained from the debate to influence the decisions they will make?

Rapport with the CEO

Board success starts with the relationships between the directors and the CEO. The CEO should regularly disagree with the board, and robust debate ought to occur, but never at the expense of good rapport. Embrace tension. Move beyond the outdated thinking that discord spells trouble, and realize that a certain degree of tension is both healthy and desirable. Contention, however, is not productive. The CEO should ask questions and question answers but all in a climate of candor and responsiveness. Trust, respect, and open communication form the foundation of any strong relationships; board relationships are no exception.

Open communication holds the keys to the kingdom of good rapport. Naturally you’ll want to be on the same page with regard to the company’s vision, mission, values, and strategy. But it takes more. Do you agree about what success will look like? Can you routinely bring the conversation around to priorities? Do directors and the CEOs trust each other to do what they say they will do, uphold the values of the organization at all times, and conduct their personal and private lives with the utmost integrity? Does everyone listen to each other?

Most CEOs don’t listen enough and make the mistake of talking too much during meetings. If the directors in the room are not worth listening to, then the wrong people serve on that board. A meeting is a chance for the CEO to hear what the directors have to say and to benefit from their collective knowledge and expertise—an opportunity to use directors as sounding boards and advisors.

Focus on Strategy

Too often boards of directors don't understand when and how they should be involved in strategy. When earnings decline, a competitor makes a sudden move, or a merger or acquisition looms, they come to life. But frequently it's too late. By not getting involved earlier in the game, directors deny executives and the company in general, the value of their input.

Stellar Boards do better. They don't formulate strategy, but they assess it, critique it, and maintain a clear focus on it. Like the princess in the story about the pea, directors need to detect flaws deep in the strategy—to notice the slight imperfections and inconsistency that prove fatal to success.

Why does strategy so often serve as such a source of angst? One reason is that boards and executives don't take a systematic approach to how they will interact with regard to strategy. The board discusses strategy piecemeal over a period of time, often in relation to something else. Or, when executives present the strategy as a finished product, directors sit idly and contribute little.

Contrast these practices to the process that the Stellar Board uses, not only to reach full agreement on the strategy but also to shape it. Executives articulate the strategic direction and clarify the measurements, criteria, timelines, and standards for evaluating it. Then, directors ask questions and offer opinions:

- Does the company have the resources, financial and human, to execute?
- Have they considered the full range of external factors?
- Have they sufficiently examined risk?
- Are the assumptions valid?
- What is the company's competitive advantage?
- How does this strategy leverage it?

- Will customers benefit?
- How will we make money with this strategy?

When directors ask these questions, they ensure that management has not made a major market entry or other strategic decision based simply on instinct, historical experience, or guesswork.

Succession Planning

Knowing where the company will go and who will take it there need to work in tandem—one the voice; the other the echo. Therefore, directors have the responsibility of planning succession for the CEO, key executives, and each other. Here are my recommendations:

1. Openly discuss each key person's plans for retirement.
2. Map out the specific role the CEO will play in finding and preparing a replacement.
3. Develop selection criteria for all key positions and director roles. Instead of putting together a list of attributes, think about what will be required in the future.
4. Two years away from the CEO's retirement, identify an internal replacement, or oversee the recruitment of one.
5. Identify high potential candidates for each executive position ten to fifteen years before any one of them is likely to reach the executive level
6. Encourage a discussion of emergency replacements for executives
7. Consider what groups you might not have represented in the current C-suite or on the board. For example, if you plan to expand in Latin America or Mexico, having a bicultural, bilingual executive or director might help you serve your growing market.

Governance

Governance underpins the board's ability to do all the aspects of its job. While strategy and succession planning address specific "What?" questions, governance deals with the "How?"

It includes, but is not limited to, decisions about the board's size, frequency of meetings, director selection, shareholder relations, and social responsibility. When a board has a governance committee, those directors initiate action plans with specific timelines for implementation of recommendations, and they have the authority to shape and recommend policy and structure.

Another key to good governance lies in better leveraging the directors' contributions. To achieve this, encourage directors to communicate regularly about their experience and expertise. You should know how to pull this from the directors when you need it, but if you have never formally gathered this kind of information, it won't exist in a time of emergency or decision-making.

Constantly evaluate whether the directors' skills, talents, and experience support the current strategy. In general, you will want directors that exhibit integrity, good judgment, strategic skills, financial literacy, confidence and high performance standards. But occasionally you might also need an industry authority, an international expert, a turnaround specialist, or a government procurement professional.

Conducting Evaluations

Leaders of Stellar Boards encourage regular evaluations of overall board functioning and of the directors. To start, have a clear, agreed-upon purpose for conducting the evaluation. Do you want to improve overall performance? Individual performance? Drive shareholder value? Or eliminate someone from the board? If it is the last, a formal evaluation might not be the best route. Clarify how information will be collected, who will have access to it, and how it will be presented to the directors collectively and individually.

The following are criteria to consider:

What is the quality of committee reports?

Are they transparent?

What is the overall relationship of the committee to the board?

Does the committee drive shareholder value?

When doing committee evaluations, both interviews and surveys work. However, all records should be "paper and pencil" so they can be shredded to protect confidentiality. The minutes will represent a summary of the process, forms, action steps, and ratings, but only in general terms, such as, "using a 4-point scale, all members of the governance committee received a 3.0 or higher on their ratings." Any other papers distributed at meetings should be collected and destroyed. Include an assessment of committees in a board evaluation.

Make evaluations complete, thorough, and efficient. Asking each director to complete an exhaustive survey—or even worse, an exhaustive survey on each peer—is an enormous use of time, and many of the directors will either not do them or will not do them in a timely fashion. When using a survey for the entire board or committees, customize it to your needs. Measure *only* those categories that are directly applicable.

Routinely evaluate the composition of the board, not just the performance of the directors. As the direction and strategy of the organization shift, so should the skills and experiences of the directors. Present the balanced findings to the board, encourage discussion, identify ways to leverage strengths, spotlight areas where adjustments need to occur, and formulate an action plan and timeline for moving forward.

In a confidential format, have directors evaluate their peers based on observable behavior that highlights how this person can add more value. Then, provide one-on-one, private feedback to each director, preferably delivered by a third party.

Ask the board to conduct separate evaluations of key executives at least once a year, but seek timely feedback in executive sessions or private conversations. Above all, *don't create materials that can be subpoenaed.* Doing these things won't guarantee you'll have a well-run board, but you will have taken significant steps in the direction of goodness.

Conclusion

Board effectiveness relies on a mutually beneficial symbiosis between the board and its directors—but that only defines the starting point. True symmetry must also occur. Like a beautifully choreographed ballet, executives and directors should move in sync with one another to the tempo of an external metronome. Success will no longer occur when people show and up comply. Instead, it will depend on leaders taking a more active role in developing and finding symmetry and symbiosis for all concerned.

Linda Henman, Ph.D. works with organizations that want to think strategically, grow dramatically, promote intelligently, and compete successfully today *and* tomorrow. She is the author of *Landing in the Executive Chair,* among other works. For more than 30 years she has helped executives and boards in Fortune 500 Companies and privately-held organizations dramatically grow their businesses. She was one of eight succession planning experts who worked directly with John Tyson after his company's acquisition of International Beef Products. Some of her other clients include Emerson Electric, Avon, Kraft Foods, Edward Jones, and Boeing. She can be reached in St. Louis at www.henmanperformancegroup.com.