

Cornerstone of the Board  
THE NEW GOVERNANCE COMMITTEE  
*volume 1, issue 2*

Beyond the Basics

# GETTING THE MOST FROM BOARD EVALUATIONS

SpencerStuart

Spencer Stuart is the foremost privately held, global executive search firm, spanning over 50 offices in 25 countries. Since 1956, we have been providing select clients with a range of human capital solutions, including senior-level executive search, board director appointments and strategic leadership services. We conduct nearly 4,000 assignments each year, partnering effectively with clients ranging from the Fortune 500, to mid-cap, to emerging growth companies across a broad range of industries and sectors.

The premier firm for board counsel and recruitment, Spencer Stuart conducts well over half of all director assignments handled through executive search. For the past 20 years, our Board Services Practice has helped boards around the world identify and recruit outside directors and provided advice to chairmen, CEOs and nominating committees on important governance issues. In the past year alone, we have conducted more than 400 director searches. We regularly partner with a diverse group of clients — from the Fortune 10 and mid-sized corporations to smaller, regional companies — to help them strengthen their board structure and performance.

In addition to our work with clients, Spencer Stuart has long played an active role in corporate governance by exploring — both on our own and with other prestigious institutions — key concerns of boards and innovative solutions to the challenges facing them. These ongoing efforts include:

The *Spencer Stuart Board Index* (SSBI), a report of board practices and governance issues at leading companies' boards, published annually for the past 18 years;

The Directors' Institute and Directors' Forum with the Wharton School at the University of Pennsylvania, held in the U.S. and the U.K.;

The Board Excellence Award with the Wharton School;

The annual Corporate Governance Conference at Northwestern University's Kellogg Graduate School of Management;

The *Directors' Roster*, published quarterly by *Directors & Boards* magazine; and

*Board Alert*, a leading corporate governance publisher with whom we co-sponsor the Directors of the Year Award, their governance newsletter and periodic bulletins on high-profile governance topics.

## MAKING BOARD EVALUATIONS EFFECTIVE

The silver lining in the cloud of corporate accounting and other scandals that reached critical mass a couple of years ago is the implementation of a number of corporate governance reforms and best practices, including regular board evaluations. These were once strictly optional, but now are required to be addressed in corporate governance guidelines by the New York Stock Exchange (NYSE) listing requirements and are, by extension, an expectation for all public companies that wish to practice good governance. In other words, board evaluations of some kind will become part of the governance standard for virtually all companies and will be among the governance committee's more important tasks. Evaluations already have become part of the threshold best practices checklist for many of the countless organizations now devoted to keeping scorecards on corporations for potential investors.

There are at least two approaches to performing the annual board evaluation:

1. Doing the bare minimum required to fulfill the requirement, such as having directors fill out a brief questionnaire.
2. Planning and executing a process that truly will add value to the board and, consequently, to shareholders.

It shouldn't surprise readers that we subscribe to the latter approach. A well thought-out and executed board evaluation process should prove beneficial even to already well-run boards, reinforcing appropriate roles and responsibilities and giving directors a regular opportunity to reassess their own resources and how they may need to be augmented.

In this issue of *Cornerstone*, we explore overall board evaluations — those targeted by the new requirements — and how boards can implement the most beneficial process. While we believe individual director evaluations also are a valuable practice, they are, for now, strictly optional and a topic worthy of exploring separately.

In writing this issue, we have drawn on our own expertise in helping our clients conduct evaluations during the last five years. Our consultants' experience in the boardroom and their interviewing expertise give Spencer Stuart a unique perspective when facilitating board evaluations. This perspective is critical in helping to draw out directors' candid comments and guiding the board discussion as it probes key issues, often in situations calling for sensitivity and sophistication. For this article, we also have incorporated the perspectives of two other experts:

- > **David Nygren** — partner in charge of the corporate governance practice at Mercer Delta Consulting Group, which consults with boards and performs the full range of board evaluations.
- > **Holly Gregory** — partner in the governance practice at Weil, Gotshal & Manges LLP, a law firm that is well-known and highly regarded for its work with leading boards.

## RAISING THE ANTE

Context is a critical consideration when approaching a board evaluation, says David Nygren, head of the corporate governance practice at Mercer Delta Consulting. While the underlying context for an annual evaluation certainly includes the new corporate governance landscape that makes the practice a de facto requirement for most boards, there are other important reasons to undertake an annual evaluation that go straight to the heart of issues such as the appropriate role of boards and how they can more effectively fulfill that role.

Beyond requiring that boards undertake an annual evaluation, the stock exchanges provide little guidance concerning what that exercise should entail. As a result, boards easily could dispense with the requirement by doing the bare minimum. Nevertheless, we encourage boards to take full advantage of the opportunity to enhance their own performance and better meet the needs of the company and its shareholders.

“If you want to push beyond the compliance focus,” says Nygren, “which is certainly what we would encourage, then you’ve got to look at the possible goals one could set. One goal might be to improve the board overall, such as its alignment with the corporate strategy. You might look at how the board can better serve and support the CEO. You might look at recruiting more and better board members or adding credibility in the eyes of shareholders. There are a lot of goals that could be served by assessing the board.”

The critical thing for directors to understand, according to Nygren, is that boards can no longer hide behind a veil of secrecy; they will be held more and more accountable legally for their actions and judgments on behalf of shareholders. Boards must raise the bar on their own performance in line with this heightened level of accountability and responsibility. “You’ve got to raise the ante. You have to raise the expectations relative to board performance. A natural consequence of the new emphasis on board performance is carefully defining the board’s roles and responsibilities, then determining whether it is performing adequately to protect the interests of shareholders.”

## WHAT TO ASSESS AND HOW?

For a board that is tackling an evaluation for the first time, Holly Gregory, partner in the governance practice at Weil, Gotshal & Manges LLP, recommends starting small and gradually building on the effort. “We are approached by boards that have never done evaluations and want us to help guide them. Other boards may have done them but are not sure they’re doing them effectively.”

For Gregory, the process starts with some general discussions at the committee level and may involve interviewing key people, including the chairman and the CEO, if the positions are separate and, if not, also the lead or presiding director, as well as any committee chairs who may be charged with leading the evaluation. “We often do some soft interviewing to get a sense of how this board and company work. What are the issues they are concerned about? How much form and process are they comfortable with?” One important area to probe initially is how the board spends its meeting time and on what sorts of issues it places the most focus. Directors sometimes find through the evaluation process that they are spending too much time on interesting, but less vital issues, and neglecting thornier, more complex and more strategic issues, says Gregory.

Both Gregory and Nygren stress that a board evaluation is not a one-size-fits-all proposition and must be tailored to the culture and goals of a particular board and company in order to be effective. A board that expects to accomplish anything substantive and relies on a ready-made evaluation form that directors fill out, likely will be disappointed by the results. Gregory emphasizes that the key to success is for the board to be actively engaged in the assessment process.

Determining what to assess is critical to designing an appropriate evaluation. Part of the problem with many evaluations, says Nygren, is that “they evaluate a board in a vacuum. You must evaluate the board in relation to the criteria that are set by the corporation and agreed on by the board so that they know they are held to a standard that is explicit.” Therefore, he recommends, “be very clear about what your objectives in the assessment process are and what you really want to accomplish by the process. I think that is so fundamental.”

Once you identify the goal, then decide the best way to achieve it, Nygren says. “We do not want to do it because it is in vogue, or simply because it is a requirement. We have to do this because it is of value. If you do not undertake an evaluation based upon a legitimate purpose that is endorsed by the board, you will not see improvement. You also cannot do it as a means of just rotating ‘dead wood’ off the board. It can be very damaging to do an assessment with a cloak-and-dagger intent. You can, however, use it positively to reshape the composition of the board.”

There are a few different approaches, which can be mixed and matched, in undertaking board evaluations, depending upon the board’s needs, prior experience, chemistry and appetite for the process. They include:

- > **Survey** — Any survey should be carefully tailored and designed for a specific company and its board, and be constructed by drawing from the corporation’s bylaws, committee charters, the roles and responsibilities of directors, and corporate governance guidelines. A specialist extracts the criteria against which the performance can be judged and will be legally defensible. You have got to make sure, Nygren reminds us, that the process applied is statistically valid and that the result is a reliable survey. Objective criteria are converted into objective behavioral measurements geared to illuminate the actual behavior of the board in critical areas. Feedback is presented in the context of a goal-setting process with the board, intended to improve performance and educate the board.

- > **Interviews** — Interviews of the board often are used prior to a board assessment — particularly where boards have not previously done an evaluation — to gain an understanding of the issues on directors' minds. Typically, an outside facilitator interviews directors individually using a structured questionnaire that takes into account the company's bylaws, charters, guidelines, and codes of conduct and ethics. Based on the results of the interviews, the governance committee provides anonymous feedback to the board, often in the form of a narrative report that is organized thematically according to key areas for board improvement.
- > **Group evaluation** — During a group evaluation, a trained consultant engages the board and the CEO in an interactive dialogue. Working against a backdrop of general best governance practices and the specific bylaws and guidelines for the company, the discussion focuses on how a board can improve its performance. Nygren stresses that this approach works best with an “evolved” board in which directors are able to talk candidly and openly, and have a limited amount of time to devote to the process. Once again, feedback is geared to setting goals for the board to improve its performance.

One issue to give careful thought to during a board evaluation is the amount and detail of written record the process may produce and the potential use of those documents, advises Gregory. “Materials generated through a board evaluation may be subject to the discovery process during litigation, so boards should carefully consider how comfortable they are with any written documentation the process generates. Ultimately, the real value of the assessment exercise is derived through the final session when the board evaluates the findings and discusses what measures, if any, to act upon,” she says.

Boards also should consider whether the evaluation process is best handled internally or whether it should be facilitated by an outside party. While there is certainly a multitude of consultants ready and willing to guide boards through the evaluation process — and there are many benefits to working with an outside facilitator — we would provide a word of caution here. It is important to choose a facilitator who has a proven track record of working with boards to devise and implement a process geared toward identifying the specific issues related to improving that board's performance, rather than one that applies a generalized approach. While a generic checklist may pass muster for now, that approach ultimately may prove to be a waste of the board's valuable time. A thorough board evaluation is worth doing and worth doing well. A board that views evaluation as a valuable opportunity to refocus on critical issues and improve performance will find itself way ahead of boards merely focused on playing the compliance game.

## THE FINAL STEPS AND BEYOND

Whether boards go it alone or work with outside assistance, there are some overall best practices to keep in mind when considering board evaluations. These best practices, combined with the specifics outlined in a board's bylaws, guidelines and charter, should help to start a constructive dialogue that achieves the goal of continually monitoring and improving performance.

Evaluations are not a magic bullet and may not even be of particular value when done in a disjointed fashion. Follow-up is critical to having the maximum impact. That includes quickly presenting results to the board and engaging directors in discussion about the results. Once the evaluation is complete, directors should be encouraged to formally recognize the results and enable follow-up activities. Follow-through should include developing a plan of action for addressing points that arise from the discussion and assigning follow-up responsibilities to the governance committee or the board chair. In order to be truly effective, board evaluations should be done on a consistent annual basis.

Board evaluations will and should change somewhat from year to year; priorities may shift depending on the critical issues facing the board. Questions should be relevant to the board's current tasks and should be based on the needs of the board at the particular time when the evaluation is planned. Moreover, questions should be targeted to focus on areas of board performance, not CEO and staff performance, which also are essential exercises, but discrete ones from evaluating the board.

## CONCLUSION

A well-planned and well-executed board evaluation that focuses on the unique culture, bylaws and needs of the board can reveal issues that hinder optimal board performance. Identifying and addressing these issues, and reinforcing the appropriate board roles and responsibilities, can yield significant benefits to the board, the company and shareholders. To derive the most value from the process, boards should define clear goals for the evaluation, choose the approach most suited to the experience and needs of the board, and conduct the appropriate follow-through.

## *Best Practices and General Parameters*

*What follows is a series of questions that may serve as a framework for exploring issues related to board performance and comparing your board to best practices:*

### **BOARD ORGANIZATION**

- > How does the board's size compare to best practice? Is the number of directors appropriate for the size of the company and directors' responsibilities? Is it too large to promote active participation by all directors?
- > How does the ratio of inside to outside directors compare to best practice?
- > Does the board as a whole possess the skills needed to adequately manage its fiduciary responsibilities and serve as a resource to management?
- > Is the board diverse?

### **BOARD PROCESS**

#### *Agendas*

- > Do directors provide input to agendas?
- > Is there adequate time for discussion of agenda items during board meetings?
- > Does the agenda provide the appropriate balance of compliance and other governance issues, and strategic versus tactical issues?
- > Do agendas reflect an annual calendar of responsibilities for the board and an annual work plan?

#### *Meetings*

- > Does the board meet often enough or too often?
- > Do board executive sessions allow for candid discussions with and without the CEO?
- > Does the board chair run meetings effectively with consideration for all opinions?
- > If the board has an annual strategic retreat, is the content meaningful?

#### *Bylaws*

- > Are bylaws adhered to?
- > Are they reviewed and updated on a timely basis?

#### *General*

- > Has the board established a calendar of agenda items that are covered at the same time each year to meet the board's fiduciary responsibilities, e.g., review of the audit of financial results?
- > Has the board set annual objectives for governance work that is needed to support the corporation's strategic plan?

#### COMMITTEES

- > Do the standing committees reflect the needs of the organization?
- > Do committee chairs understand what is required of them and are they effective?
- > Does each committee have a formal charter and understand its requirements?
- > Do committees meet often enough or too often?
- > Do committee chairs report to the board in a way that encourages discussion of appropriate issues and accurately reflects committee discussion?

#### COMMUNICATION

- > Do board members show respect for one another's points of view through active listening?
- > Do board members promote frank and open discussion with management?
- > Does the board provide the CEO with a meaningful and candid annual performance review?
- > Is the board satisfied that management keeps it informed about significant events that occur between board meetings?

#### BOARD MATERIALS

- > Are materials received well enough in advance of the meeting to be thoroughly reviewed?
- > Are materials presented in enough or too much detail?

#### PRIMARY BOARD RESPONSIBILITIES

How would you rate the board on fulfilling the following key accountabilities:

- > Compliance with new regulations
- > CEO relationship
- > Management succession
- > Strategic planning
- > Financial oversight
- > Board succession and governance
- > Preparedness to act cohesively in the event of an unforeseen crisis

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