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The Executive Guide

# IMPROVING BOARD EFFECTIVENESS

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## FIVE PRINCIPLES FOR GETTING THE MOST OUT OF A BOARD ASSESSMENT

Corporate boards today are expected to be more engaged, more knowledgeable and more effective than in the past. One tool that a growing number of boards are using to examine and improve their effectiveness is the board evaluation. Annual assessments have become the norm for boards in many countries, with nearly all listed companies in Canada, France, the U.K. and the U.S. conducting some sort of assessment each year. The practice is also widespread in Italy and Spain and is gaining attention in many Asia Pacific markets, where the issue of board effectiveness is moving up on the corporate governance agenda.

Despite their growing adoption, board assessments are falling short of their promise of enhancing board effectiveness in some cases. Boards that take a compliance-oriented approach — or structure the process in a way that prevents a true examination of the impediments to board effectiveness — lose the opportunity to gain valuable shared insight into the operation of the board and ways to improve its composition, processes and relationships.

When done effectively, board evaluations provide a forum for directors to review and reinforce appropriate board and management roles and ensure that issues that may lie below the surface are identified and addressed promptly. In short, evaluations give the board an opportunity to identify and remove obstacles to better performance and to highlight best practices.

How can boards make sure that they get the most out of the assessments, so that they really improve board effectiveness? In our experience, boards derive the highest value from a board assessment that is shaped by five key principles:

The board has clear objectives for the evaluation.

A board leader drives the process.

The process incorporates perspectives from senior managers who regularly interact with the board.

The assessment process goes beyond compliance issues to examine board effectiveness across a broad range of measures.

Directors commit to reviewing the results of the assessment together and address issues that emerge.

# 1 The board agrees on clear objectives for the assessment.

One of the most common mistakes boards can make when embarking on an assessment is failing to agree at the outset on the purpose and objectives of the process. While it may seem obvious, coming to a shared agreement about what directors collectively want to accomplish through the assessment encourages board members to commit time to the process and to provide the candid feedback that is essential to identifying and addressing potential roadblocks to board effectiveness. Without the commitment from the board as a whole and directors individually, an assessment is unlikely to yield the desired results. Clarifying objectives and defining the scope of the assessment also helps to avoid a situation in which the board is using the process as a way to put off dealing more directly with non-performing directors.

For some boards, a “triggering event,” such as the arrival of a new CEO or a change in board leadership or composition can shape the priorities and objectives of the assessment. For example, an assessment occurring amid a CEO transition can help forge an understanding between the CEO and the board about expectations and accountabilities, clarify the respective roles of the board and CEO and ensure that time is spent early in the CEO’s tenure to consider whether changes are needed in the way the board is composed, structured or operates.

Furthermore, board structures, governance issues and cultural norms differ by company and country, and these differences also can affect the style and scope of the board assessment. To be most effective, a board assessment must be tailored to the company’s current business context and include any relevant issues.

## How common are annual board assessments?

An annual board effectiveness assessment is now a widespread practice in many European markets and in North America. Interest in board assessments is growing in Asia Pacific.

Percentage of Major Listed Companies Conducting an Annual Board Assessment

Canada	France	Germany	Italy	Spain	U.K.	U.S.
100%	100%	44%	84%	60%	98%	99%

Source: Spencer Stuart research, company reporting

## Among the questions boards should consider at the outset:

**What is the scope of the assessment?** For example, should the process only involve assessments of the board and committees, as required in many countries, or also include individual director assessments? Boards with little experience conducting assessments may define a narrower scope the first year, expanding the scope in subsequent years as directors become more confident and comfortable with the process.

**What's the most appropriate assessment approach for the board?** Boards approach assessments in a variety of ways, ranging from a director questionnaire to a robust process in which directors are interviewed individually, typically by a third party, to draw out candid views about the board's effectiveness.

**Should board leaders be assessed?** Our experience is that the board's effectiveness is impacted directly by the board's leadership. Even though the chair is guiding the process, the best situation is when that person is open to feedback about his or her leadership.

**What areas does the board want to delve into more deeply?** These areas could include board process, behaviors, communication issues, the effectiveness of executive sessions, the role of the lead independent director, the board's relationship to management and development of the board's agenda. In countries where annual assessments are required, some boards find the process more valuable when each year they choose a specific topic — such as the board's committee structure or its role in the strategic planning process — to examine more closely.

**What gaps exist in the current assessment process?** Boards can become dissatisfied with assessment techniques that fail to get at issues that are impacting their effectiveness. It is helpful at the start of the assessment to consider whether to evolve the assessment approach or the issues that are reviewed in order to make the process more productive.

### 2 A board leader is responsible for driving the process.

Essential to a successful evaluation is having an independent board leader champion the assessment process. The independent board chair, chair of the governance committee or the lead independent director is in a position to drive the process — involve the right people, ask for directors' time, schedule time on the agenda to discuss the results and ensure that the board follows up on the issues that emerge. And while the CEO should be an integral part of the process, he or she should not be leading it.

The board leader driving the assessment process plays a significant role in managing expectations about the process, serves as an independent resource for directors and management to turn to with concerns, and may deliver feedback to individual directors, if the board is not working with a third party to facilitate the process.

### 3 The process incorporates perspectives beyond the board directors themselves, including those from senior management and best practices from outside the company.

Another way the board can limit the value of a board assessment is to look only inwardly at its own effectiveness. An emerging best practice among U.S. boards, although still less common in European boards, is to seek input about the board's effectiveness from the key senior management team members who interface with the board. Soliciting input from the executives who participate in most of the board meetings — such as the general counsel, the president, the

chief financial officer and head of human resources — can broaden the perspectives on the board’s effectiveness in key areas, including board/management relations. As regular board observers, these executives often have very thoughtful feedback about what the board does well and what it could do better.

Board assessments also can be more valuable when boards benchmark themselves against other high-performing boards in the same industry segment or against best practices in a specific area. For example, boards often want to know how they compare to peers in areas such as committee structure, compensation and mandatory retirement age. A third-party facilitator with significant experience in the boardroom and knowledge of governance guidelines and regulations can provide perspectives on how the board compares to its peers or “measures up” to the evolving standards of corporate governance by providing an up-to-date perspective on best practices.

## 4 The assessment process should go beyond compliance issues to examine board effectiveness.

Many boards have relied on director questionnaires to conduct their assessments. This paper-and-pencil approach can provide a sense of how directors are feeling about compliance issues — whether or not the board is involved in strategy discussions or CEO evaluations, for example — but they are less valuable in revealing issues or concerns that are affecting the board’s effectiveness. While a board may be doing all of the things it is supposed to be doing by law, these activities may not be yielding results that are improving the outcomes for the company. Similarly, behaviors on the board may be preventing the board from serving as a strategic adviser for management or limiting its strategic influence.

In the most effective board assessments, directors are interviewed individually on a confidential basis and asked for both their qualitative and quantitative assessment of the key areas that determine the effectiveness of the board. The assessment interviews should be conducted by a seasoned boardroom consultant who understands boardroom issues and CEO/board relations. Interviews typically are wide-ranging discussions, examining everything from board composition and organization, board processes, roles and responsibilities to communication, boardroom dynamics, the board/management relationship and the quality of boardroom discussion.

As part of our process, we recommend that a full board evaluation include a review of governance documents, committee charters, board meeting minutes, board meeting agendas and observation of a board meeting. Observing the board dynamics and exchanges between directors during live meetings can be a very useful input when providing advice and recommendations for improvement, particularly related to the quality of board discussions.

The assessment process can reveal a variety of issues and obstacles to better board performance. These range from easily addressed operational complaints about meeting length or the composition of the agenda, to larger, thornier issues concerning the board’s role in strategic decision-making, gaps in knowledge and competencies on the board, and executive and director succession planning. The corrective actions range as well — from improving the timeliness of board materials and winnowing overly long agendas, to making changes in the composition and, occasionally, the leadership of the board.

### What can a board effectiveness assessment include?

- Board processes and supporting materials
- Board composition
- Committee organization and processes
- The role of the board and board leaders
- The board’s relationship with the CEO
- Board culture and dynamics
- Potential board development needs
- Overall board effectiveness
- Individual director effectiveness

While many of the concerns that surface through evaluations focus on board procedures, they sometimes go to the important relationship between the board and management, which can vary depending on the size and development stage of the company, the international makeup of the board and the current state of the business. In Europe, many boards also are re-examining the board's involvement in areas such as succession planning and strategy planning, considering whether the board should be more involved earlier in the process, for example, to review the competitive assumptions that are shaping management's strategic plan.

## 5 Directors commit to reviewing the results of the assessment and prepare an action plan for addressing issues that emerged.

Another way assessments can fall short is when boards do not commit the time to review the results and address the issues that are raised. Some boards, for compliance reasons, begin an assessment process, but then spend little or no time on discussing the findings. In addition to leaving issues unresolved, this lack of follow-up can generate cynicism about the process and the board leadership's commitment to improving effectiveness in the future.

Boards have to be open to the results of the assessment and be prepared to deal with the findings. This involves having an open discussion among the board members about performance issues that were raised and prioritizing items that should be addressed in the coming year. Follow-up is typically delegated to the governance committee, which develops an action plan based on the board recommendations. The board reviews its progress as part of the following year's assessment.

## Conclusion

Done properly, a board assessment is not a report card for the board as a whole or for individual directors. Instead, it should be viewed as a tool for continuous improvement and learning. Successful assessment processes:

- Reflect the culture of the organization and its board
- Are championed by a chairman or other board leader who participates actively in the process
- Have shared support among all directors
- Begin with clearly stated objectives for the board assessment process
- Include adequate time on the board's agenda to discuss the results and establish a clear approach for acting on the findings, including developing an action plan with a timeline and milestones
- Are characterized by confidentiality throughout the process

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