Value-Add Board Evaluations: What to Look For

By Susan F. Shultz

Until Enron Corp., and more recently at organizations like American International Group Inc., Citibank and the nonprofits that invested in Bernard Madoff, corporate governance was an afterthought. Today, effective boards of directors are recognized as a mainspring of corporate success. Because our free enterprise system rests on trust and integrity, transparency is essential. And checks and balances are an imperative, which means evaluation.

Due to the financial crisis and government intervention, the traditional role of boards is threatened by an increased sentiment that directors are failing to do their jobs. Board evaluations can be a way to raise the bar to the next level and demonstrate effectiveness and a commitment to improvement.

In many cases, however, boards never receive the rigorous, independent evaluation they deserve.

The New York Stock Exchange and the U.S. Securities and Exchange Commission have mandated annual evaluations of the full board and the mandated committees. Directors and officers insurers, rating agencies and shareholder groups reward companies that conduct independent board evaluations. Further, the overwhelming majority of corporate board charters require annual evaluations. In 2009, 94 percent of all S&P 500 boards conducted annual performance evaluations (up from 90 percent in 2008, according to the 2009 Spencer Stuart Board Index).

Insurers, shareholder advocacy groups, institutional investors, venture capitalists, public accountants, attorneys, employees, suppliers and all others with a stake in an organization's success, are seeking accountability and transparency.

The financial team is integral to the evaluation process. The board depends heavily on the financial team to provide the right information, to present risk dashboards, to accurately project future earnings and to provide actionable guidance. Often, it's the CFO or a member of the financial team who recommends the evaluation solution to the organization and/or facilitates it.

According to a recent PricewaterhouseCoopers study, only 11 percent of board members feel that their board evaluation process is "very effective," and 43 percent feel that there is significant room for improvement.

All evaluations are valuable, because they focus on board effectiveness. However, most evaluations are cobbled together in-house.

Often, the confidentiality of evaluations is compromised. Everyone knows who says what. With in-house questionnaires or in discussions with consultants, directors are unlikely to criticize, because they might offend the leadership, and the criticism could be traced back to them.

In order to realize the benefits of board evaluations, most companies have established rudimentary internal processes to accomplish this task. These processes — most of which are manual and ad hoc — do not provide the depth, breadth, standardization or repeatability necessary to fully reap the benefits of an independent board evaluation. A good evaluation allows directors to focus on the business of the business and continuously enhance the productivity of the board.

As the responsibilities of boards escalate, more is expected of committees. So, separate, comprehensive committee assessments are increasingly important. Audit committees, especially, are undergoing tremendous reform and scrutiny.

Boards need an objectively developed, easy-to-use evaluation system, so that the directors are not perceived as self-serving by asking the same questions they answer. The board should control the process, choose who responds — ideally all the directors and those who work with the board – establish the timeline and add questions they feel are important to their company. The board should determine who should lead the discussion, whether internally or through an outside facilitator. In all cases, the board should agree on a plan of action to make any agreed-on improvements and to benchmark their actions year to year.

Above all, the evaluation process should be fast and simple to use and understand, yield actionable results and provide strategic input for each director.

Assessment is a positive. The focus is where it should be — on better boards.

The 11 Most Important Attributes Of a Good Evaluation

- **Objectivity:** Questions are developed independently of the company and the board.
- **Benchmarking:** Internally and against best practices year to year.
- **Professional Design:** The right questions are asked in the right way to ensure the greatest validity.
- **Analytics:** Detailed, actionable results clearly highlight board strengths and weaknesses.
- **Educational Accreditation:** Fulfills governance educational requirements.
- **Anonymous. Confidential. Secure:** Privacy protection to promote candor and ensure corporate security.
- **Customizable:** Questions specific to a particular board can be incorporated.
- **Qualitative and Quantitative:** Strike a good balance between the two types of questions through scientific methodology.
- **Board-Centric:** The board has exclusive control of the process and any action taken.
- **Easy to Implement:** May be facilitated internally (self-directed) or externally.
- **Separate Evaluations:** Tailored to the board, the committees and the individual directors.

Evaluation is as valuable for good boards as it is for those boards seeking improvement. The opportunity is to move beyond compliance to a strategic board that adds value to the business. Good boards mean good companies.

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