

THE CORPORATE BOARD

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Self-Assessment: Making Good Boards Better

Time to “professionalize” your board evaluation.

by Roger M. Kenny

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Self-Assessment: Making Good Boards Better

by Roger M. Kenny

The Sarbanes-Oxley law and its resulting stock exchange reform rules have driven boards to make self-assessment a part of their agenda. Yet spectacular failures at some of America's biggest financial firms (who presumably had some of our best boards) are prompting questions about just how well boards evaluate themselves. Do they seek usable answers? Do they measure the correct skills? Can boards really ask themselves tough questions—and deliver tough changes?

Now that we have witnessed the demise of Bear Stearns, Lehman Brothers, Merrill Lynch and Wachovia (and the bailout of Fannie Mae, Freddie Mac, AIG and Citigroup), any director who sits on a financial services board has to be speculating about the causes of failure in each case. It would be useful to interview these board members to learn what they would have done differently.

How would they have gotten to know more about the businesses of their company, about its finances and the risks involved? In particular, what was each board's approach to self-assessment as mandated by the self-assessment rule of the New York Stock Exchange? Would that have made a difference?

Unfortunately, a misconception exists about the NYSE's board self-assessment rule. Too many boards first equated critical self-evaluation with potential legal liability and followed the rule within a compliant but limited scope.

In the five years that it has been in place, however, none of our clients and, to our knowledge, no company has been harmed by following the rule. In fact, in those five years, the process of self-assessment has expanded as boards experience the increasingly positive results of a truly candid self-assessment. Why should boards not assess themselves the same way they must assess management?

In following the NYSE's board self-assessment rule, most companies rely on internal surveys, which consist of check-off sheets with room for comments. Results so far have been mixed, and typically not very candid. The rule never intended that we just check boxes or issue report cards. Its intention was to make "good boards better boards" for the purpose of oversight.

We believe the best way to achieve this is by involving a trusted third party in the process. We have found that confidential, third party interviews with each director produce much more candid and self-critical results, especially when it is clear that no attribution to anyone is given.

A true evaluation takes place only after each member of a board has been surveyed, interviewed and reviewed for full results, and has then participated in formulating a comprehensive report, which each director must review and approve. Only then can someone speak for the board as a whole and give feedback to individual directors.

Board evaluation has to focus on what is most important to its directors now, and requires an assessment process designed to help with that focus.

There is no one right way or set of "best practices" that fits all boards when it comes to self-assessment. Each board must focus on its own current issues, its own evolving strategy and its own priorities. This means every board has to focus on what is most important to its directors now, and requires that the assessment process be designed to help with that focus. The first step in shaping a board self-assessment

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survey is to identify what key issues this particular board must concentrate on now.

Since there are typically only about 50 or 60 hours of “face time” each year for each board member with management, one of the more important goals of each board’s self-assessment is helping a director come to grips with his or her role. Specifically, identify which of the many director’s responsibilities is most important for the company to focus on at the moment. This can include:

- Succession.
- Strategy.
- CEO evaluation.
- Structure—focusing on more dialogue.
- Learning more about the business.
- Understanding the drivers of competition.
- The board’s own succession and assessment programs and evaluating candidates.
- Strengthening board leadership.

For each board, understanding where their priority roles lay is the first step to improvement.

Self-assessment helps boards measure their most important function—CEO succession planning. Replacing a failed management team is really a sign of board failure.

A board self-evaluation process helps directors come to grips with their most important function—driving succession planning. This is certainly one of the things that is aired in each self-assessment, and no board wants to be in a position of not having succession choices for the future. Neither does any board want to replace a failing management team—that is really the *directors’* failure.

Today, boards want choices for the future in each of the key top management positions. That means bench strength—and bench strength is expensive. In the past, management would frequently say we could not afford it. Today directors are saying, “You can’t afford *not* to have a strong bench.” This major shift has led to “benchmarking” both inside and outside the company as part of the succession pipeline. Benchmarking is now one of the more important things a

board can do to guarantee leadership choices. This is a whole new role for boards.

The board must ensure a well-crafted management development process that positions the company for a steady infusion of new leadership. Primarily, the directors have to have a clear plan for choosing the next CEO. The board must be completely objective about the CEO’s selection, knowing there are sensitive issues involved, including the current CEO’s desires.

It boils down to what the board has agreed are the “non-negotiable” criteria for the CEO role. It requires asking the question: “Does this person meet all of the criteria?” The question is not “How much does he or she deserve the position?” Selecting CEOs on a “deserving” basis is one of the biggest fumbles in a board’s responsibility for succession, and has harmed many companies.

Boards also need to have an emergency succession plan in place, and not just follow a “hit by the bus” scenario. They have to answer the question, “Does our emergency plan meet the near-term needs of the company, encompassing a possible six-month term, until a permanent CEO solution is found?”

When it comes to strategy, management today seems more welcoming of directors’ inputs, and invites them to share their areas of expertise. Directors want to be more comfortable and clear about strategy and this takes dialogue, time and commitment.

Typically, when directors discuss strategy at its highest level with management, both have things in common. When they dig deeper, however, the strategy frequently becomes unclear. At the same time, directors are anxious to learn more about the business from management so they can make more of a contribution.

Right now, we are performing an assessment in an industry that is going through a lot of consolidation, complicated by other strategic issues. This particular board needs to get up to speed quickly to help management. These directors need major indoctrination. Can this company provide sufficient “on-boarding” experience?

This is one example of where a board with diverse experience can add real value. Even just one or two

industry veterans can make a huge difference. Every board must have some members who are in tune with, and who understand, the operating side of the business and have a realistic view of the industry and competition.

Also, a governance culture that supports different points of view, but is engaged, will tend to support management to stay the course on strategy. Directors make a large contribution by asking the right questions at the right level. Management then develops the strategy along with alternatives, and invites the board to discuss these alternatives.

Oftentimes, management believes that directors have not learned as much as they need to about their particular businesses to be effective in helping with strategy. In our experience, this is a shortcoming of most boards, but they are struggling with ways to change this. New educational resources need to be provided, and directors should take the time to come up to speed.

The typical “on-boarding” process requires major overhaul, and management needs to take responsibility for this. Perhaps this “on-boarding process” is a new role for human resources. As it stands now, most boards are not feeling enough “presence” from human resources, and this additional responsibility could help unite that function with the board.

“Show me a board that does a good job of CEO evaluation, and I will show you a good board.”

CEO evaluation is still a concern of most boards. With the internal and external pressures on the compensation committee and the evolution of the lead director, CEO assessment should be addressed each year. Henry Wendt, the former chairman of Smith Kline Beecham, and one of Boardroom Consultants’ advisory board members, reflected on the 10 or so boards he participated in during his career by saying, “Show me a board that does a good job of CEO evaluation, and I will show you a good board.”

Another one of Henry Wendt’s gems of wisdom was: “After all these years, I believe most of the best

and worst things that happened to companies started at the board.” This puts emphasis on having the right directors in order to become a better board.

Every board periodically needs to upgrade itself with new skills and relevant experiences that are useful to management, and aligned with the company’s strategic direction. Boards need mechanisms to help them upgrade and, from time to time, replace a director. Directors should understand that no board seat is forever. Frankly, some directors outlive their effectiveness, and should voluntarily give up their seat to new directors with needed skills.

Boards tend to be so collegial that delegating the task of evaluating its members to the lead director usually will not bring the correct level of candor. This situation can be overcome by the introduction of a trusted, independent advisor, who, when appropriate, could say, “Sir, here is what the board is telling us,” or “What we really need in this seat is a strong marketing executive or an IT expert.”

These highly professional, well-intentioned people usually respond positively, professionally and constructively. It probably would make a lot of sense for each director to be assessed by fellow directors before standing for re-election.

Involving top management in the board’s self-assessment process gives the board an important dimension of feedback on management’s needs and expectations. In some cases, the process has also shown how management would like to be treated, and has unveiled behavioral issues on the part of some directors that is viewed as dysfunctional, or as crossing the line or not contributing enough of one’s expertise.

Management deserves and must receive respect from all members of the board and, at the same time, expects help from the board. Where this healthy balance exists, we find it much easier to attract directors. Potential directors will want to join a board where management really wants their help and respects their involvement.

The lead director of a board (or its equivalent, the presiding director) is a new development within the last five or so years. Now, over 94 percent of all public companies have a lead director, according

The Role Of The Board

An Evaluation Checklist

- Supporting and consulting with management on specific issues.
- Clarifying strategic direction.
- Adding to CEO succession options and benchmarking, and providing choices for the future.
- Evaluating the management team, their development needs and their respective succession plans; adding to the bench strength.
- Formally evaluating the CEO, with emphasis on performance results.
- Understanding the company's business and competition, and how the company makes money.
- Stimulating the management to actively take on the most important company issues going forward.
- Strengthening board skills/experience; adding directors to make sure the board improves its skills.
- Strengthening board leadership; making sure the best person is in charge of the board and can speak for the board.
- Focusing board meetings more on key issues, like risk and succession, rather than routine presentations.
- Strengthening communications and actions with management between board meetings.
- Improving information received by the board.
- Strengthening board succession and assessment programs and evaluating new prospects.
- Reviewing operational performance.
- Providing oversight on compliance issues.

to a 2007 Spencer Stuart Survey. Four years ago, only 30 percent had one. What made us think that independent directors never needed a leader of their own? That should have been obvious after the General Motors and IBM crises of the early 1990s and later the Enron, WorldCom and Tyco crises.

Usually, we find that the lead director is selected because of the respect he or she has earned from management and fellow board members as well as his or her skills and comfort in communicating with management, skills displayed in discussing the results of executive sessions. Defining the lead

director role (and helping and evaluating the lead director each year) provides a guarantee that the role is working and that helps guarantee an independent board. The board self-assessment process reinforces the independent board leadership concept.

With only about 50 hours a year of "face time" between directors and management, there is a need to fine tune the board's agenda. Board meetings should cover fewer topics more thoroughly, and especially should involve fewer presentations. Today, directors want dialogue on major issues. They do not want to have repetitious presentations of material they have already read.

Today, the need is "dialogue, or die as a board." That, of course, presumes that the directors are well prepared for each board meeting and they have read and absorbed all the required material. If they cannot, they should not stay on the board. Rehashing material in board meetings wastes valuable face time.

The independent board assessment process is for good boards that want to become better boards. There is nothing better than a peer review to give confidence to shareholders.

Board self-assessments generate candor, especially when using a trusted, confidential advisor. This advisor, in turn, can speak for the board in many ways without giving attribution to anyone and without quoting anyone. The independent advisor can say, "This is what the board is saying." No individual director can say that, not even the lead director. Most companies who have used just surveys internally have had limited results at best, and we believe the time has come to take this valuable process to the next level.

Why should every board and its individual members not receive confidential feedback through one-on-one interviews with the directors and a trusted third party? This would be someone who not only brings impartiality, but also the information and judgment required to put the real issues on the table.

The independent board assessment process is for good boards that want to become better boards. Plus,

as members stand for re-election, it is very helpful to have them reviewed by their fellow-directors. There is nothing better than a peer review to give confidence to shareholders.

□ *What does board assessment entail?* By drawing upon the observations of each of the board members, as well as management, we can, together, gauge the general functioning of the board, its committees and policies. The board learns what seems to be working best and where there is room for improvement. This review benefits greatly from personal interviews with each director and manager, and helps bring about agreement on specific actions and practices where changes may make sense.

The review helps ensure that the company's future board structure, membership and practices are aligned with its needs going forward. This is a highly interactive process. We conduct this exercise to help enhance board contributions and foster improved interaction within the boardroom and with management. This process typically takes a few months to complete and, when entered into with trust and enthusiasm, can yield valuable and often unexpected insights on many levels.

□ **Define the focus.** One of the important first steps is to scope out the areas of governance content of greatest importance to the board through preliminary discussions with the head of the nominating and governance committee, the chairman and CEO, and others as needed. The purpose of this scouting is to make sure that we will focus on the real issues that are most critical at this time.

□ **Survey design.** Only then can we design a survey that elicits candid feedback from individual directors on a broad range of topics, with an emphasis on issues of greatest importance to the board and company. Designed properly, this survey should elicit substantive comments, and not just checking off items of relative importance.

□ **One-on-one discussion.** The survey is followed up with one-on-one discussions with each board member to deepen our understanding and further probe areas of concern. These one-on-one interviews elicit candid comments, which are invaluable to the overall results of the survey.

□ **Analysis and summary.** Candidly and confidentially, we analyze and summarize the combined survey and interview results. This involves pointing out those areas where attention is needed, without giving attribution to individual board members or even quoting anyone, because sometimes quotes can be identified.

□ **Preliminary written report.** The result is a written report prepared for the nominating and governance committee's review. The committee sees unvarnished views of board members and management, with the addition of best practices and perspectives from our advisors. When the nominating and governance committee approves the report, it is then sent to the rest of the board and the CEO.

□ **Final written report.** The final report includes specific recommendations on performance improvement, roles, structure, procedures, communications and all aspects of governance to ensure that the board's practices are the best possible in relation to the company's issues, goals and challenges. The report specifically outlines how good boards can become better. Recommendations are presented to the full board at their next meeting. Action plans are included to be followed up on a predetermined basis.

After completing the board self-assessment, directors report they are more productive and efficient. Their efforts were rewarded.

In every assessment so far, our clients say that the board has performed exceedingly well in subsequent board meetings, dialogue has improved, and the board has come together and resolved some long-standing issues. In some cases, individual directors have chosen not to stand for re-election, and the board's succession plan has been firmed up. In all cases, directors have reported that their board meetings have never been so productive and efficient, and their efforts so rewarded.

Through a sound self-assessment process, issues that held up progress were eliminated, and an action plan for the future was put in place. ■

Boardroom

CONSULTANTS

About Boardroom Consultants

Boardroom Consultants is the first firm to specialize exclusively in director recruitment and board services with over 400 successful director placements, numerous board assessments and governance consulting assignments for leading business organizations.

Boardroom Consultants draws on the collective knowledge of an Advisory Board composed of former chief executives and business leaders with significant board experience to provide consultative services important to superior board performance. As trusted advisors to clients, Boardroom Consultants provides discreet, objective board assessments, succession planning, and other services that make boards valuable assets.

Boardroom Consultants supplements its extensive experience and unmatched expertise in building high-performing boards with the research and support resources available from Slayton Search Partners, a respected and fast growing leader in retained executive search.

Boardroom Consultants and Slayton Search Partners share a common commitment to provide a wider pool of exceptional candidates, for the boardroom and the executive suite, typically a multiple of what the large firms can deliver.

This distinctive approach enables Boardroom Consultants and Slayton Search Partners to make the search experience a limit-less® opportunity for building exceptional leadership for both boards and management. We believe it's the right model for the future.

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