Tomorrow’s Corporate Governance

Improving board evaluation for greater board effectiveness
About Tomorrow’s Good Governance Forum

The Forum was formed in March 2010 in response to questions raised about the effectiveness of corporate governance as a result of the financial crisis and the subsequent reviews by Sir David Walker and the FRC.

It brings together a number of key businesses, organisations and individuals to explore what good governance means, to make practical recommendations to company boards and policy makers.

This publication is the fifth in a series of guides and tool-kits from the Tomorrow’s Good Governance Forum for use by chairmen, boards and advisors, to help achieve practical change.

The first in the series was ‘The case for the Board Mandate’ which advocates the creation of a formal mandate by boards as a useful framework for internal strategic decision-making and subsequent communication.

This was followed by ‘Improving the quality of boardroom conversations’ which focuses on the importance of, and how to get the right level of engagement in board conversations to get the very best from the skills and abilities around the board table.

The third, ‘The boardroom and risk’ highlights powerful evidence to suggest that there is a serious gap in the way that many boards identify and address significant risk issues and discusses how boards can achieve a greater understanding and control over these strategically important risk exposures.

‘Tomorrow’s Risk Leadership: delivering risk resilience and business performance’ was the fourth in the series and puts forward the case for all organisations to rethink their risk leadership and consider the value of a dedicated executive risk leadership role.

In addition to these guides and tool-kits, the publication ‘Tomorrow’s Chairman’ explores what makes for a great chairman now and in the future. It uses the format of a series of letters to a new chairman to offer advice and experience from a range of stakeholders.

Other useful information can also be found on: www.tomorrowscorporategovernance.com

If you would like to become a member of the Good Governance Forum please contact: ceo@tomorrowscompany.com
Foreword

The board, with its responsibilities to shareholders for the care, development and welfare of its business, is arguably the most important body in any company.

How it exercises its duties and influences its business is probably the most important issue facing chairmen and directors today.

To make sure it is effective a board must have some way of measuring and reviewing its performance with a clear path for updating and improving itself.

Probably one of the best things that has come out of our obsession with corporate governance in the last ten years has been the board evaluation process. The three-year period which has evolved for this process, an independent external review followed by two years of self-assessment, is the most useful and effective time period for boards to assimilate and implement changes.

This guide contains many useful tips on how to conduct and get value out of the evaluation process. I would highlight three of my own which apply to the evaluator.

First, the external evaluator must be truly independent and not appointed by the chairman whose job and performance is under review along with the board.

Second, they should be experienced and be able not only to evaluate performance but also bring knowledge of other boards and best practice, giving the board some sense of where it sits against others.

Third, they must leave the board with a set of recommendations for it to consider and, if appropriate, follow up in the ‘self-assessment years’. No matter how good a board is it can always improve and must evolve with time.

Finally, I do not believe that these evaluations should be viewed as simply ‘good corporate governance’ but more as a practical tool to improve performance which companies should be striving to achieve in all parts of their business.

John Barton
Chairman, easyJet plc and Next plc.
Effective board evaluation is an integral part of good governance. Reflection and learning are critical to the effective performance and development of all individuals and teams. For a board, the annual board evaluation process provides an important opportunity to pause and take stock of how well it leads and is undertaking its role in adding value to the organisation and the key relationships on which it depends for its success.

While processes are important, good governance is achieved through the right behaviours – which is why the Good Governance Forum’s (GGF) agenda is focused on improving board dynamics and behaviour.

Through the research and consultations undertaken by the GGF to date, the following have been identified as being key to effective boardroom behaviour:

- having a shared view of the distinctiveness of the company, what it stands for and what it is seeking to achieve – what the GGF calls a ‘board mandate’
- being able to have deep, meaningful and effective conversations which draw on all the skills, abilities and experience of the board members so that the shared view is continually refreshed, understanding the changing nature of the risk landscape, including a recognition that the behaviour of the board itself is a key risk.
Board evaluation is not only of fundamental importance to the board but to a much wider group of stakeholders:

- Senior management who are not board members need good direction and support from the board.
- Employees look to the board to create value and to demonstrate how the purpose of the organisation should be achieved in line with its stated values.
- Customers and society at large increasingly expect the board of an organisation to ensure that value is being created and in a way that respects society. Failure to meet these expectations leads to damaged brand and reputation, and missed business opportunities.
- Creating value is increasingly reliant on strategic relationships with networks of suppliers who therefore have a shared interest in the success of the organisation.
- The board is elected by shareholders who have a responsibility to satisfy themselves that the board is exercising good stewardship of the organisation.

Every company and board is unique and board evaluation needs to be tailored accordingly. While acknowledging that every evaluation will be bespoke, this guide highlights some common issues to be considered and presents some good practice drawn from the experience of chairs, company secretaries, investors and evaluators to help get the best value from the process.
"It is important to remember what we are trying to achieve with the evaluation. It is about the effectiveness of the board in adding value to shareholders - and other stakeholders including society as a whole. It is about entrepreneurial leadership... such as tone from the top, culture and values, how well crises are avoided or managed. It also offers a valuable opportunity to obtain feedback which can then be passed on in later conversations with executives or NEDs. And it does not need to be about too grand an issue... it can be small things that make a difference.”

David Tyler, chairman, J Sainsbury plc

“Board evaluations can be an important safety valve for a dysfunctional board. However, if the chairman is doing his job well and has a good relationship with the SID, then the results of the evaluation should not come as a surprise. Ongoing informal meetings with the NEDs and executives outside of board meetings should have already identified any major issues that need to be dealt with. While they can be a helpful catalyst for continuous improvement, I would be shocked and disappointed if a board evaluation identified a serious issue I wasn’t already aware of.”

Lord Norman Blackwell, chairman, Lloyds Banking Group

“There is value and purpose in board evaluation if undertaken in the right spirit. As a chair you set the tone for the board and I focus on openness and learning. All boards can be improved and the issues change with the changing people on the board and the fortunes of the business and its strategic landscape. This openness to change and improve flows through into board evaluations. I encourage a no holds barred approach – everyone needs to be honest about what improvements could be made. We also adopt a candid approach to reporting so that investors and others can see the board dynamics.”

Robert Swannell, chairman, Marks and Spencer plc

“Small concerns can grow in importance if not dealt with. Board evaluation provides an important periodic check on how well the board is functioning and an opportunity to air and resolve any issues even in well performing boards. There is always room for improvement.”

Ian Barlow, NED and chair of audit committee at Smith & Nephew plc, Foxtons and Brunner Investment Trust plc, and lead NED, HMRC
“As a professional services firm, we are clearly not obliged to comply with the Code. However, the board has grown considerably in its functioning and 'conversation' by undertaking an evaluation. My role as chairman, working with the executive and non-executive board members has, as a consequence, been made more satisfying. We have very much enjoyed being part of this review of board evaluation for that reason.”

Andrew Witts, chairman, Gowling WLG (UK) LLP

“It is hard to meet with investors around board evaluation unless there is a problem and then they are split into two groups – the corporate governance specialist and the investment side. The latter are not interested in what they see as the 'soft stuff', and if the chair asks if they want to know about this then they say they have already spoken to the CEO!”

Sir John Armitt, chairman, National Express Group plc

“Evaluating board performance should not be seen as a one-off annual exercise and the company secretary is well placed to observe the dynamics and relationships on an ongoing basis. In reality they often do the heavy lifting on board evaluation and the resultant action plans.”

Clare Wardle, general counsel & company secretary, Coca-Cola European Partners

“It is important not to solely place emphasis on the board interviews themselves as there will be many other sources of information on which to draw to assess the overall effectiveness of the board - for example the type and content of board papers, minutes of committees, selection criteria and process for board members, employee engagement feedback, customer research, discussions with investors etc.”

Richard Sykes, former partner, PwC
Where we are and where next?

Richard Sermon, chief executive of The Chairmen’s Forum

So what have we learned from board evaluation so far and is it improving board effectiveness? This, in essence, was the ‘examination’ question posed by Sir David Walker in a breakfast conversation some months ago with a group of senior chairmen reflecting on the introduction of Board Evaluation as part of the UK Corporate Governance Code in 2002.

We have since consulted over 30 experienced chairmen and a similar number of company secretaries, investors, leading evaluators and other specialist discussants in an effort to share experience in a structured way on the still evolving practice of board evaluation.

The answer to the ‘examination’ question was overwhelmingly positive but in no way complacent. Board effectiveness, after all, depends not only on a thorough and skilful evaluation but upon the board embracing a culture of openness and embarking on a programme of continuous improvement and collective self-awareness.

This guide has been written primarily with chairmen in mind – it is for each board to determine how it undertakes ‘a formal and rigorous, evaluation of its own performance’ each year and the basis upon which it conducts ‘an externally facilitated review’ every three years. This is not an area for a ‘one size fits all’ approach and so you will find nothing which is prescriptive in these pages but rather insights, ideas and examples of ‘what good looks like’.

From our conversations there are clearly a number of areas for potential improvement. Selecting just three I would highlight:

• Improving the level and quality of disclosure of the outcomes of the board evaluation
• Improving the quality of the dialogue between investors and boards in the round
• Improving the overall quality, consistency and ‘bench depth’ available within the board evaluation community and the intelligent use of self-assessment materials

And where will we need to be in five years’ time? In the months and years ahead, boards will come under increasing pressure to be seen to be exercising effective stewardship and to manage their engagement with all their key stakeholders in a positive and pro-active way. This will require board effectiveness of a high order.

Amongst the keys to success will be the ability of the board to address the need to embed their thinking and integrate their management reporting on culture, risk and diversity into board information flows. Once you have read the guide, you will have your own views and priorities for improving board effectiveness and I hope that you will share these with us.
Introduction

Board evaluation is an integral part of corporate governance in the UK. It helps boards operate more effectively. This guide offers some examples of good practice to help chairmen get the best value from the board evaluation process.

Although board evaluation has been a feature of the best boards for many years, in 2002 it became a formal requirement in the UK Corporate Governance Code (the Code) for boards to “undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors”. The requirements were extended in 2010 to include an externally facilitated review every three years for FTSE 350 companies.²

However, while the Code requirement has been adopted by most companies there is still room for improvement in the way they communicate the issues that arise from it. According to the Grant Thornton study in 2015, around a third of the FTSE 350 companies were undertaking an external review. 46% of the FTSE 100 companies provided good quality descriptions of the outputs and actions arising from the board evaluations.³

Like any good performance evaluation process, board evaluation needs to be as objective and rigorous as possible. At its best it is a positive process of learning and improvement rather than an attempt to identify failings. And like any process it is not without its tensions and challenges.

The aim of the evaluation is to provide “…a powerful and valuable feedback mechanism for improving board effectiveness, maximising strengths and highlighting areas for further development.”⁴

Too often, however, there are shareholders, politicians and media commentators who talk as if its purpose is to pass judgement on the board. This can instil fear which can then weaken a board’s willingness to do it thoroughly.

Much of the effectiveness of a board relies on the skills, experience and personality of the chair – on his/her ability to get the best from all those around the board table and weave this into a sum greater than its parts and to build trusted relationships to encourage robust challenge and respect for diverse views.

The very best company chairmen are restless in the demands they place upon themselves and their boards to achieve and drive improvement, not to rest on their laurels, but to test, refine and improve. They recognise that they must add value to the business and are thoughtful and determined in how they best achieve this.
For a board evaluation to produce worthwhile and actionable results, there is an onus on the chair, supported by the company secretary to create a supportive culture of openness and learning within the board so that all those involved feel that they can be honest.

This can be a challenge, especially where there are clear signs that the board is not functioning to the best of its collective capability. Also, since the SID is responsible for the evaluation of the chair’s performance, the nature of the relationship between chair and SID needs to be particularly strong and mutually supportive.

The relationship between the external evaluator and the chair is another vital element in how effective the review will be. This needs to be one of mutual trust and confidence. Equally there is a danger that the relationship becomes too comfortable if the same evaluator is used time and time again.

During the course of the research we have heard concerns expressed about the variable quality of those undertaking external evaluations and the very limited number of evaluators which are regarded as strong in their field. According to Grant Thornton, in 2015 there were 41 independent evaluators of the FTSE 350 companies named as having commissioned an external evaluation. Three of these consultants undertook an aggregate of 48 evaluations, the remaining 38 evaluators providing on average two each.5

This is of concern given the importance of board evaluation in helping boards ensure that they are adding value.

Many evaluators have their own set of principles. In addition, a set of guiding principles has been developed to help reduce the variability of methodologies and hence quality of reviews. These were driven by the desire of some long-term investors who view board evaluation as part of being a good steward and were developed in consultation with a number of leading evaluators and regulators. These are shown opposite.
Four Guiding Principles for Evaluators

**Independence** - the evaluator must be able to exercise independent and objective judgement. Existing commercial relationships, and other conflicts of interest, should be avoided, and/or disclosed and managed.

**Confidentiality** - the evaluator must keep all information confidential. The only exception to this is the discovery of unlawful practices or regulatory demands.

**Competency** - the evaluator will disclose the skills and competences of each individual involved in the evaluation, and provide appropriate references. There must be alignment of expectation between the client and the evaluator with regard to quality, value and longevity of service.

**Follow-up** - the evaluator will discuss progress on agreed outcomes with clients (to include the Chairman, SID and/or Board) within 6-12 months of the evaluation.

Three Guiding Principles for Clients

**Cooperation** - there must be full cooperation between the client and the evaluator in order to ensure integrity of process. This will include transparency of, and appropriate access to, Board and Committee information, participants, and meetings.

**Transparency** - all disclosures, including the Annual Report, must identify the evaluator (and any conflicts), the methodology (including the use of interviews and observation), final outcomes (with reference to accepted recommendations), and the approval process.

**Approval** - the evaluator should agree and approve any formal disclosures, including the Annual Report, which describe the evaluation.
Creating the brief – the ‘what’

Defining effectiveness

The starting point for any evaluation is to set out the brief and be clear about its purpose and focus. The overarching purpose of the evaluation is to assess the effectiveness of the board in adding value to the organisation and how effectively the chair is performing in the role of helping the board add that value.

This begs the question… what does effectiveness mean? And what does an effective board look like for the organisation?

The strategic objectives are often used as the main foundation for board evaluations, supplemented by performance objectives and KPIs. Another approach is to reflect on the seven director’s duties as defined by the Companies Act 2006.7

But these are only some of the facets of effectiveness. Much of what constitutes good governance is behavioural and not easily translatable into performance indicators.

A key starting point for an effective board is the degree to which its members have a shared view of what the organisation stands for, what it is seeking to achieve and how. The Good Governance Forum, convened by Tomorrow’s Company, describes this as a ‘board mandate’ – a living statement of the ‘essence’ of the ‘character’ and distinctiveness of the company, in terms of its essential purpose; its aspirations; the values by which it intends to operate; its attitude to integrity, risk, safety and the environment; its culture; its value proposition to investors; and plans for development.8 This working charter can help the board by facilitating strategic engagement between executive directors and NEDs to improve board effectiveness. From this should flow a clear understanding of how the board, and its respective committees, need to operate.

The UK Corporate Governance Code also states that “Evaluation of the board should consider the balance of skills, experience, independence and knowledge of the company on the board, its diversity, including gender, how the board works together as a unit, and other factors relevant to its effectiveness.”

One of the factors central to ‘how well the board works together’ is communication. Creating a shared view of what the organisation stands for, being able to act in line with this and getting the very best from the skills and abilities around the board table requires deep and meaningful conversations.
The quality of boardroom conversations, the quality of the chair and the quality and value gained from a board mandate are inherently linked.

The fundamental precept of the board as a governance tool is the belief that the best way to lead an enterprise is in the interchange and sharing of knowledge, experience, ideas, facts and perspectives between the managers of the business, who know all its nooks and crannies, and outsiders, who know less but have more detachment and objectivity. The medium for this interchange is conversation. The more effective the conversations, the more effective the board. Poor boardroom conversations can be a symptom of more fundamental issues that may be impacting the effectiveness of a board such as the influence of dominant personalities or groups within the board, lack of preparation and inappropriate allocation of time to matters requiring discussion and debate.9

Amongst the ‘other factors’ mentioned in the Code is also a key group of risks that can have catastrophic consequences for organisations that go beyond traditional risk management analysis and techniques. These include the potential risk that the functioning of the board itself can pose. For example, inadequate skills and the inability of the board to influence executives, inadequate leadership on ethos and culture and defective information flows to and from the board.10 Lack of board succession planning also risks undermining the effectiveness and sustainability of the board.11

Given the array of factors that can impact the performance of the board, taking the time to be clear about what constitutes effectiveness for the board and for its committees is essential. Some organisations have this discussion as a board so that there is a shared agreement of what is being assessed. The advantage of this approach is that it can create a wider sense of ownership and encourage more enthusiastic and honest participation.

The cycle of board evaluation may be adapted for a specific purpose and in such cases it would not be appropriate to involve the whole board in creating the brief. One example would be an evaluation held just as a chair has been appointed. Here the purpose might be to gain insight into how the board is currently operating. Another example might be where it is clear that the behaviour of a particular board member is having a negative impact on the board and feedback is being sought to feed into one-to-one discussions with the individual.
**Roles**

It is the role of the chair to lead the process of defining effectiveness, working with the evaluator to draw together the various strands so that all the relevant aspects will be covered by the review.

Where the review is an external one, then the chair will also be responsible for the selection of the evaluator.

While the chair is responsible, the senior independent director (SID) and company secretary help to drive the process.

The company secretary has a key role in supporting the chair although the responsibility should not be delegated to them. However, given the exposure of the company secretary to board members and familiarity with the inner workings of the board, they are well placed to observe some of the dynamics and may provide useful pointers on areas that the evaluation might focus on.

With regard to the part of the evaluation concerned with the performance of the chair, the Code states that “The non-executive directors, led by the senior independent director, should be responsible for performance evaluation of the chairman, taking into account the views of executive directors, led by the Senior Independent Director (SID).” The evaluation of the role of the chair is bound to be sensitive and therefore the relationship between the chair and SID needs to be an effective and trusted one.

Finally, a good evaluator will not just take the brief as read. They will use their intuition and experience from other companies as well as any previous experience with the particular company to include areas where potential problems might lie. They will also take care to draw out experiences and learnings where something has gone wrong – reviewing mistakes can provide important learning and insights. A good evaluator will “smell the barn” as one evaluator put it!
Perspective from a chairman

Roger Parry CBE, chairman YouGov plc, Oxford Metrics plc and MSQ Partners Ltd.

It is too easy to assume a group of high achieving people will automatically become a highly functional board. Their collective performance as a team does need to be assessed and any weaknesses in the collective performance identified. They normally need external help to make this assessment.

A challenge with board evaluation techniques is that ‘one size does not fit all’.

Evaluating the performance of individual managers is similar in large and small, public and private companies. But evaluating the performance of boards must recognise they have somewhat different roles and functions depending on the type of organisation.

Some boards have to focus on regulatory compliance and risk, others much more on performance and operational monitoring. Any evaluation process must start with a clear understanding of, and a consensus from its members about, what a board is trying to achieve and thus what criteria it should be judged by.

Being chairman of a small private equity backed start-up requires a very different style and approach from presiding over a FTSE 100 financial service business but the same people may be on both boards.
Creating the brief – the ‘who’

In the interests of obtaining a balanced view, good performance appraisals seek to include as wide a range of input as possible. This can include self-assessment, peer to peer feedback as well as feedback from external relationships.

The same principle applies to board evaluation. Widening the sources of feedback to include executives who are not members of the board, senior management and employees at other levels of the organisation can help give a more rounded view of the value that the board is adding to the organisation.

It could be argued that feedback from key external relationships is also important because these are crucial to a company’s continued success and licence to operate.

Making maximum use of all the different sources of information can help give the board as wide a sense as possible of how the company and their performance is viewed by its stakeholders and can add a layer of richness and added value to the evaluation.

However, it is not yet routine to seek the views of investors, employees, suppliers or wider society. This is partly because of cost concerns if an external evaluation is involved. The other challenge is one of methodology – how can feedback from society at large be obtained about whether the board is performing effectively?

This highlights the need to seek out other sources of information to supplement the surveys and/or interviews undertaken as part of the evaluation process. Most companies will have routine feedback mechanisms in place to assess the level of employee engagement/voice, customer satisfaction and retention, performance of suppliers, investor relationships and brand awareness. All these can provide useful insights for the evaluation.

In terms of investor sentiment, the UK Stewardship Code has encouraged greater engagement and a higher quality of dialogue between institutional investors and companies. Dialogue with institutional investors building upon the disclosures made by institutions under the Code should assist companies to understand the approach and expectations of their major shareholders. Some boards also ask for a regular verbal update from their investor relations team including investors’ views about the company’s strengths and weaknesses and general perceptions.
Social media is growing in importance as a mechanism for getting feedback from employees, customers and society at large. There is now a generation of employees who will have been brought up with social media and they will expect organisations to use these channels as widely as they do.

However, social media has yet to be fully harnessed for the purpose of feedback even though new tools and methodologies are continually being developed for data collection and analysis.

There are some companies that actively encourage their employees to use social media to build dialogues with customers, and through this medium valuable insight about consumer sentiment can be gained.

Social media is also replacing traditional online employee surveys as a way to assess employee engagement. This approach has the advantage of capturing good qualitative as well as quantitative data.\(^\text{13}\)

Many companies will be pulling all this information together on an ongoing basis to inform the board and executive of the company’s progress in different relationships. This data could in turn be used to inform internal evaluations and may be of value to an external evaluator in helping them assess the degree of knowledge the board has of the views of their different stakeholders.
Appointing an external evaluator

Finding the right evaluator is crucial to the success of the evaluation.

The relationship needed between the chair and the evaluator has to be open, honest, trusting and free from conflicts of interest. This has the advantage of increasing effectiveness but the potential danger of comfort and complacency over time.

There is a range of individuals and organisations providing board evaluations services and their backgrounds range from head hunters to former human resource directors to coaches to specialised consultancies.

When board effectiveness evaluations were first required, head hunters offered their services building on the existing relationship they had with the chair. This created a potential conflict of interest since the closeness of the relationship might lead to a reluctance to be critical of those they had recruited into the post. The marketplace for evaluators has diversified and grown, but it is still important to recognise and address potential conflicts.

Matching the skills of the evaluator with the focus of the evaluation will ensure that the evaluation is as fruitful and effective as possible. For example, there are evaluators who have a strong background in ethnography or psychology and therefore have a keen ability to observe behavioural dynamics amongst the board members and draw inferences from this observation. Other evaluators may be less skilled in this and focus more on procedure and process.

The choice of evaluator will also depend on the stage of development that the board is at – whether it is a relatively new board or mature and working well.

We have also noted from our research that chairs often contact their peers for advice when looking for an evaluator and it is becoming common practice to take formal references.

Finally, because of the relationships built between evaluators and chairs, particular evaluators may have busy diaries. It is therefore important to plan well ahead in terms of booking the next evaluation. Sometimes this can be over a year ahead. This has the advantage of enabling the evaluator to feed into the internal review process to provide a useful foundation on which to build the external review the following year.
Disclosing the results

Disclosure of the results has been a thorny issue in our discussions, particularly with chairs and investors. There is a tendency to view the process as one of necessity rather than an integral part of good governance. Disclosure is part of the overall circle of accountability which is a mark of effective governance. And good disclosure is a mark of good governance.

Feedback to the board

The real benefit that comes from the board evaluation process does not lie in the written report itself but in the quality of the discussion that it prompts and the actions taken as a result.

The chair is responsible for ensuring that the results of the evaluation are fed back to the board. Ideally, this is best done in full, ‘warts and all’, without prior editing and with the evaluator present.

This brings us back to the character of the chair. Being transparent and open demands what one chair described as “being egoless” and putting the board and the company first. By not being defensive this also sends a signal to others that they do not need to be.

The same principles apply to the evaluation of the chair by the NEDs.

Disclosure in the annual report

While the contents of the annual report may be of interest to all stakeholders, one of the primary audiences for the information on board evaluation is investors.

The issues of most concern and interest to investors will be the same as those that should be of concern to a chair or SID in terms of board effectiveness such as whether the mix of skills is right for the business now and to meet future challenges.

In our consultations, chairs and SIDs welcomed the interest of investors but noted that such interest was not always shown by portfolio managers as much as by governance specialists. Chairs and SIDs felt that it would be more helpful if major investors raised the issue as part of their overall interest as a key partner in driving the success of the business. Also, sometimes when a chair raises the subject of evaluation with investors their response is that they have already spoken to the CEO – so there can be an unhelpful disconnect within the investor organisation.
There is still a great deal of variability in the level of detail disclosed about the board evaluation and the majority of companies still do not disclose a good level of detail in their annual report. The primary criticism is that the information presented is often too ‘boilerplate’ and gives little indication of or insight into what the issues were and how they are going to be addressed.

There is an inevitable tension in striking the right balance between reporting the detail versus protecting the value derived from the process in terms of learning and reflection. Any reticence to disclose more detail may also be due to the reporting requirement being viewed as a compliance exercise rather than a communication opportunity through which to gain greater loyalty and support from its stakeholders.

However, the best companies do disclose as much of the evaluation as possible and ensure that the evaluator has agreed and approved the disclosure.

The most important aspects of the evaluation in the view of the investors we consulted are the methods used and who in the organisation was consulted as these will give a good indication of the depth and thoroughness of the evaluation; along with the action plan, as this enables investors to have a constructive discussion with the chair at their meetings.

While the annual report provides a good starting point, a deeper understanding comes from the private conversations with the chair or SID. Even then investors report that it is sometimes hard to get a sense of the chair’s contribution to the board’s effectiveness e.g. the degree to which they are mentoring and assisting NEDs.

One of the most effective approaches from the perspectives of investors we consulted is for the conversation with investors to take place with both the chair and the SID at the same time as this gives them a better feel about how well they work together. Some companies also hold an annual ‘stewardship’ meeting with their shareholders which is primarily focused on strategy, and therefore values, succession planning and the board evaluation are also discussed.

Another suggestion made to encourage less boilerplate statements is for the chair to make a personal statement in the annual report as to how useful they found the review.
The Code requires that:

B.6.1. “The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted.”

The supplementary guidance to the Code goes further in stating:

5.3 “The outcome of a board evaluation should be shared with the whole board and fed back, as appropriate, into the board’s work on composition, the design of induction and development programmes, and other relevant areas. It may be useful for a company to have a review loop to consider how effective the board evaluation process has been.

7.2. The annual report is an important means of communicating with shareholders. It can also be used to provide well thought-out disclosures on the company’s governance arrangements and the board evaluation exercise. Thinking about such disclosures can prompt the board to reflect on the quality of its governance, and what actions it might take to improve its structures, processes and systems.”
Board reviews are about good stewardship not just good governance.

Sacha Sadan, corporate governance director, Legal and General Investment Management

As long-term investors we want to help companies be as good as they can be.

An effective board is central to any successful company. A board should promote diversity of thought and succession planning to ensure it has the skills and experience required to be best positioned for its future direction. Moreover, it creates and fosters a culture of openness and transparency to build trust and encourage rigorous debate between the executives and non-executives. However, the quality of the debate and interaction inside companies is difficult for investors to determine from the outside.

Externally facilitated board reviews are powerful tools to help companies improve and evolve. Reviewers can bring a fresh pair of eyes, as well as experience of how other boards operate and how common problems can be solved. The aim should be to improve company boards in the interests of investors.

As a significant investor, we want all companies in the market to undertake board reviews that are rigorous and a value-added exercise; not just undertaking a review ‘because they have to’ or ‘to tick a box’.

These reviews should be more in equilibrium between investors and companies rather than tilted towards management. Fundamental to achieving this is providing in the annual report and accounts transparency around the methodology used, the findings and what action plan is in place to address areas of improvements, recognising that sensitivity around some issues may prevent full public disclosure.

In some instances, we also feel it is important to engage with the Chairman and/or SID following a review to discuss the outcomes of the review for the board and its committees and processes, as well as what changes have been made and the action points being taken forward.

Board reviews are an evolving practice and there is scope to improve communication around review processes and outcomes to improve the overall quality across the industry. At present there are no standards in place and with the diverse range of providers being used, the quality is still inevitably variable. Hence why we helped to develop the guiding principles shown on page 9.

Active ownership is a philosophy that looks at all areas of corporate performance. For us, board reviews are therefore a key part of being a good owner or steward of the business.
The action plan

The action plan will have resulted from the facilitated board discussion about the findings of the review. Sometimes all the recommendations will be adopted. Sometimes a few will be selected for action over a given time period. Well-organised boards will then factor the plan into their forward agendas for regular review and provide an update in the annual report.

Like any ‘plan’ there is a danger that it becomes an end in itself and not constantly reviewed as an ongoing part of board discussions. Taking action based on the results of the evaluation, and learning from the changes made, ensures that the evaluation is woven into the fabric of governance and adds value to the workings and effectiveness of the board.

The company secretary has a key role to play in helping the chair ensure that this happens by ensuring appropriate time is taken on ‘packed agendas’ for reflection and learning and by monitoring and recording the actions taken and improvements made.

Some good practices we have identified are:

• Tasking a NED to critique the last board meeting at the start of the next meeting in the context of the action plan.

• Pausing for reflection and seeking comment at the end of each board meeting from each of the board members. This retains a focus on the action plan, but creates a virtuous circle of openness, continual learning and trust.

• Setting aside time for a full review by the board of the action plan and progress ahead of the next evaluation.

But what if there are ‘no issues’ as a result of the board evaluation? While it would be hoped that there are no surprises if the board is working well on a day to day basis, having no need for an action plan could be taken as a red flag that either the evaluation was not undertaken well or that some or all of the board members do not place sufficient value on the process!
### The most effective board evaluation...

<table>
<thead>
<tr>
<th>IS</th>
<th>IS NOT</th>
</tr>
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<tbody>
<tr>
<td><strong>IS</strong> part of a yearly cycle of governance and a prompt to reflection and learning</td>
<td><strong>IS NOT</strong> an end in itself undertaken purely to comply with FRC guidelines.</td>
</tr>
<tr>
<td><strong>BEGINS</strong> after discussion among the chair, SID and company secretary with a clear brief to the evaluator which sets out the uniqueness of the organisation and what it needs from its board to fulfil its value creation potential</td>
<td><strong>IS NOT</strong> a private exercise commissioned by the chairman in isolation.</td>
</tr>
<tr>
<td><strong>IS</strong> grounded in the purpose, values and strategy of the company and the mandate the board has defined for itself</td>
<td><strong>IS NOT</strong> a standard product easily replicated from company to company.</td>
</tr>
<tr>
<td><strong>IS</strong> informative to the chair and board about what they can improve in board dynamics and behaviours and what they can learn from other boards</td>
<td><strong>IS NOT</strong> restricted to suggestions about board papers and board process.</td>
</tr>
<tr>
<td><strong>IS</strong> based on actual observation of the board in action as well as interviews with board members and involves as wide a range of additional input as possible e.g. self-assessment, peer-to-peer feedback, feedback from external relationships</td>
<td><strong>IS NOT</strong> restricted to interviews or surveys with board members.</td>
</tr>
<tr>
<td><strong>IS</strong> openly and honestly disclosed in the form of a summary of process and outcomes that is agreed by the evaluator as accurate and provides a basis for more detailed and private follow-up conversations with investors, executives and other interested parties</td>
<td><strong>DOES NOT</strong> offer a blow-by-blow account of board dynamics in a way that could compromise those giving frank feedback; is not presented as passing an external judgement on the board or have all critical feedback edited out.</td>
</tr>
<tr>
<td><strong>LEADS TO</strong> an action plan based on the results of the evaluation and learning from the changes made and is referred to in the planning and conduct of later board meetings. The chair, SID and company secretary embed the evaluation within the fabric of governance and ensures that it adds value to the workings and effectiveness of the board</td>
<td><strong>IS NOT</strong> ignored at future board meetings or the plan filed away on completion of the review.</td>
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</tbody>
</table>
Improving board evaluation to achieve greater board effectiveness

Tomorrow’s Corporate Governance

Board evaluation and the virtuous circle of governance

Mark Goyder, founder and chief executive, Tomorrow’s Company

Talk to any experienced entrepreneur or business founder about corporate governance. Usually the eyes glaze over. They will tell you that they are more interested in wealth generation than red tape.

Yet corporate governance exists to underpin enterprise and wealth creation, not to dampen it. It is all about creating and maintaining the boundaries and the conditions under which entrepreneurs and all those who work in their businesses can continue to be enterprising. As Tomorrow’s Company suggested 14 years ago:

“The company is a living system. Employees are its life-blood. Management is the heart which keeps the blood pumping. Strategy is the brain and measurement and communication the central nervous system. Culture is the DNA. Leadership and continued entrepreneurial energy are its soul and spirit. Governance and accountability are its rhythms and disciplines, like exercise, a means of keeping this living organism fit and lean. Unless we understand governance in this wide context, we will continually fail to manage risk, sustain performance and earn trust.”

For too long governance has been identified with compliance and the ticking of boxes. It is actually best seen as a virtuous circle.

In previous publications Tomorrow’s Company has developed the concepts and tool-kits that help fulfil the different elements of this virtuous circle. Thus the Board Mandate offers a process for defining purpose, values, key relationships, and success model. Similarly the work on corporate reporting has developed a clear agenda for those now aspiring to achieve integrated reporting.

A good board effectiveness review and its follow-up can be seen as the chairman’s own completion of this virtuous circle. It is a process of shared learning and feedback to inform the chairman and others what is working and what may need to be changed. Thinking critically about one’s own performance and tackling any weaknesses as a result creates value itself and understanding the board evaluation process can indicate managers’ ability and willingness to improve continuously. It will at its best lead to a communication which builds the confidence of shareholders and other stakeholders in the board’s effectiveness and ability to adapt in a timely manner.

And therein lies the challenge. How to fulfil the internal purpose – which requires the privacy of the confessional – while also fulfilling the external purpose, which requires a public sharing of what has been learned and what may change. So far only a few have managed it. It is hoped that this guide will help more do so.
Sources and notes

1 For example, see:


- According to a YouGov poll for the CBI 55% of people agreed that expectations on business ‘to do the right thing’ had risen over the last 10 years. CBI/YouGov, April 2014. Available at: http://www.thegreatbusinessdebate.co.uk/assets/uploads/2014/08/Factsheet-3-Customers.pdf [accessed July 2016]

- According to the 2016 Deloitte Millennial survey, the millennial generation (87 percent) believe that “the success of a business should be measured in terms of more than just its financial performance”. Available at: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/About-Deloitte/gx-millenial-survey-2016-exec-summary.pdf [accessed July 16]

- In the 2013 Nielsen global survey, Nielsen used stated willingness to spend more on goods and services from companies that have implemented programs to give back to society as a proxy for how much consumers care about brand investments in social impact. Half of all respondents (50%) said they would be willing to reward companies that give back to society by paying more for their goods and services. Available at: http://www.nielsen.com/us/en/insights/reports/2013/consumers-who-care.html [accessed July 16]

- In July 2016, there were 1554 signatories to the Principle of Responsible Investment representing more than US$59 trillion. Available at: http://www.unpri.org/about-pri/about-pri/ [accessed July 16]


6 Available at:
   • Boardroom Review. Available at: http://boardroomreview.com/welcome#principles [accessed July 16]

7 The Companies Act 2006 sets out seven general duties of directors:
   • to act within powers in accordance with the company’s constitution and to use those powers only for the purposes for which they were conferred
   • to promote the success of the company for the benefit of its members
   • to exercise independent judgement
   • to exercise reasonable care, skill and diligence
   • to avoid conflicts of interest
   • not to accept benefits from third parties
   • to declare an interest in a proposed transaction or arrangement.


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We as Forum members welcome this document as an important contribution to improving the effectiveness of corporate governance.

This guide is the fifth in a series of publications, proposing instruments and practical tools for consideration by chairs, chief executives, company secretaries and other key figures responsible for the quality of corporate governance. Together these publications will provide an essential guide to good governance.

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Help improve board evaluation for greater board effectiveness
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