

Board appraisal

Alan Frost revisits corporate governance.

THIS IS THE THIRD OF A SERIES of papers on the topic of corporate governance. In an article in *The Actuary* last May, Malcolm Lewis and I described why we felt corporate governance was entering a new phase. Last November Nick Taylor joined us in preparing a paper for SIAS which considered various topics in governance. Nick concentrated on actuarial governance; Malcolm, an accountant, discussed the role of governance in value creation; and I surveyed the differing nature of boards, the various types of non-executive director, and the overall governance framework. In this article I shall consider the appraisal process for boards as a body and for individuals sitting on them. The Higgs Report has now been published, but this article is a simple guide to board appraisal and not a resumé of the Higgs Report.

The context for my observations is involvement with several boards of great diversity. It is now clear that there is a general move to board appraisal. I understand that it is patchy and that individual appraisal processes are more likely to be undertaken if those closely involved happen to be in their 50s and younger, rather than their 60s and older. This ageist feature reflects the fact that those younger are more likely to be familiar with formal appraisal methods, while the older group are less likely to have encountered these in their careers.

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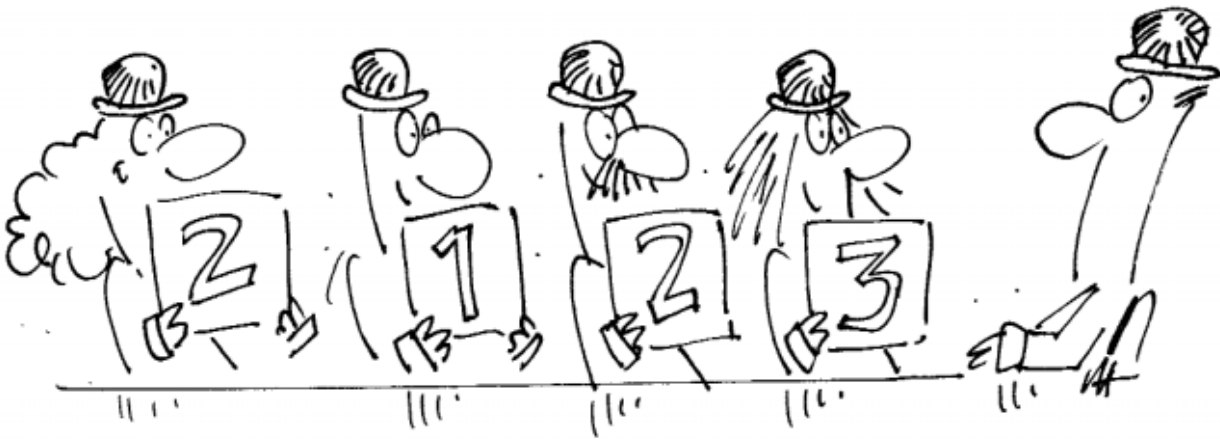
Who should conduct a board appraisal?

Ideally, the review should be conducted internally. In practice, it seems the process is often uncomfortable, so a consultant is hired. In the long run it should be a customary matter for the nominations committee. A number of consultants have entered this arena and offer various bespoke services to organisations. A personal discussion between the consultant and the board members is obligatory and helpful. A debrief to the whole board follows, with some general areas for discussion and improvement. The process is open and the degree of incisive change that may follow will reflect the styles of the organisation, the chairman, and the chief executive. The recommendations will vary from the fairly trivial – such as the board agreeing to meet informally for a dinner more often – to the more precise recommendation of a rebalancing of board competencies. In any event the board will expect comments on the items listed below in the box.

The Higgs Report makes the recommendation that the performance of the board, its committees, and its individual members ‘should be evaluated at least once a year’. Higgs refers to the number of non-executive directors as a proportion of the total and suggests the nominations committee should review the performance of non-executive directors. A number of his proposals have proved very controversial, but many of his recommendations are common sense.

The benefits of conducting a board appraisal?

- 1 Most organisations exist to meet goals established by articles of governance of some sort. Boards should review periodically whether their structures are enabling them to meet those ends, or whether changes are required.
- 2 Many concerns require diversity on the board to understand better the needs of customers, suppliers, regulators, employees, and so on. The process of rebalancing competencies is achieved best by means of a formal board audit.
- 3 Ethnic, sexual, and cultural diversity are essential, if not legal requirements, in many organisations. The traditional white middle-class middle-aged male is still omnipresent on many boards, although this is changing.
- 4 Most boards now ask non-executive directors to serve fixed terms of office and this is one of Higgs’s proposals. This should ensure the board is refreshed regularly. It is still possible to find organisations where directors expect to serve indefinitely. Removal of such long-serving retainers can test the diplomatic skills of the shrewdest chairman. A methodical survey of board effectiveness makes the process more palatable and transparent.
- 5 Large boards in particular function most effectively by means of subcommittees. A review of board efficacy enables the roles of subcommittees to be audited and their composition renewed, if appropriate.
- 6 Information flow is essential to any board and the nature and frequency of this should be monitored routinely.
- 7 The frequency and length of board meetings also requires regular examination.
- 8 It is useful if appraisal of the board also covers the following items:
 - a The balance between executives and non-executives.
 - b The technical competencies of the non-executive team (marketing, sales, risk management, HR, IT, etc).
 - c How often the board members meet informally. There is a slight conflict at this point. While non-executives are essential for their independence of thought, some fraternisation and teamwork is helpful.
 - d The manner in which debate takes place. Is there sufficient time for ideas to be discussed with vigour? Are decisions made effectively?
 - e The relationship between the chairman, chief executive, and non-executives.
 - f Whether executives, other than the chief executive, understand and are comfortable with their role on the board.



My own observations conclude the effectiveness of a board depends on:

- ◆ the quality of non-executives and executives and, especially, the chairman;
- ◆ the culture of the organisation;
- ◆ the size of the board;
- ◆ the funds and expertise available to support helpful governance;
- ◆ the positioning and role of stakeholders.

How should a non-executive director be appraised?

This is the most sensitive issue of all. In organisations such as charities, where recruitment is difficult, it is inconceivable that a pro bono trustee would submit him/herself to appraisal. The character of many commercial directors means this may be assumed to be a tricky situation for them too. Higgs's work was based largely on large listed companies. A university board of 24 directors presents a practical problem for the chairman, as he (or she) is expected to see each non-executive for a one-hour appraisal session. And who appraises the chairman?

Appraisal systems for employees are often highly formalised, and the associated discussion inappropriate for non-executives with highly charged egos. Higgs outlines suggested guidance on performance evaluation for the board and the individual non-executive director. It is early days for many companies, but this guidance gives some idea of how it might work.

The aim, as with employees, is to help individuals to maximise their contribution to the organisation. Some appropriate cycle of timing needs to be established, whether yearly or less frequently, and a decision taken on whether there is an annual cycle or appraisals are linked to start dates.

In most cases the chairman has to be the appraiser, after gathering informal input from subcommittee chairmen and the chief executive. The chairman of the internal audit committee may be the right person to review the chairman, but there may be another official of the organisation in a better position to do so. As intimated earlier it is highly unlikely that captains of industry of a certain age are likely to welcome

a 360° appraisal! Any paperwork will be minimal and confidential to the chairman and a few others. Results will be limited to those who need to know.

The interview itself will probably be of the fireside chat variety – relaxed and informal. The interviewee will be expected to review, among other things, the previous year's contribution, relationships with fellow board members, goals for the coming year, and developmental needs. The latter will be fairly benign, such as joining or moving to another subcommittee, or attending a conference. The process of mentoring new arrivals to a board has also gathered pace, and experienced board members will be expected carry out this task. I have no doubt that some of these discussions will take place over a good lunch – and why not?

In short

Board appraisal is now a fact of corporate life. The Higgs Report has met much criticism and may well be amended for practical usage.

The goal must be to enhance the functioning of boards to avoid the type of high-profile disasters we have read so much about recently. It can be argued that some failures are the result of a perpetuation of past practices and stultification. A formal board review can offer a helpful catalyst for change.

As far as individual appraisal is concerned, I am sure it will be civilised, and that chairmen will find suitable ways of motivating continuing non-executives or suggesting departures from the board in the interests of the common good.

The very best boards have always followed a process similar to that described, but the current movement is about raising standards generally. It is regrettable that those who have pursued high-quality governance within organisations from board level downwards are now required to 'tick boxes' to prove their competence. The plain fact is that there has been insufficient excellence demonstrated. □

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References

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