BOARD APPRAISALS:
From compliance to success

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By Professor Sir Andrew Likierman

In 'Frasier,' the television soap which follows the fortunes of a Seattle-based psychoanalyst, the eponymous hero's brother gloomily summarises a task ahead. "Difficult and boring," he sighs, "my favourite combination." Many organisations approach board appraisal in just this spirit. It doesn't have to be that way. A successful board appraisal can not only be interesting, but also add significant value to an organisation by helping poor-performing boards sort out problems and the better ones get better. An unsuccessful appraisal can at best be a waste of valuable time, at worst destructive. Set out below is the basis for measuring that success.

WHAT'S AVAILABLE?

There is a lot of information available on compliance and 'process', but very little on how to succeed. That's probably not surprising, since systematic and regular appraisals haven't been around for very long. When boards were dominated by executives and when non-executives were family members, the great and the good or golf cronies, chairmen would have regarded the idea of compliance as audacious and/or a waste of time. Any 'dirty linen' was left dirty or washed in private.

Another reason for the lack of material on judging compliance success may be that for many organisations they are imposed from the 'outside'. In the UK, the impetus was provided by the high-profile scandals of the late 80s, including Maxwell, BCCI and Polly Peck. These brought demands for better corporate governance, a better function of the board.

A final reason for the lack of material may well be that it is seen to be too difficult to make the assessment, either technically, in terms of personal egos or because of complicated group dynamics. There may be fears about what the process might uncover: 'We just don't have the time', 'We don't have anyone to do it', 'We don't need it' and 'We can't afford it' are classic rationalisations.

BACKGROUND

Let's first remind ourselves what's required, and clarify the distinction between good processes and success. Listed companies in the UK are required to report that a board appraisal (including Committees) has not only been conducted but how it has been undertaken. The Stock Exchange Combined Code states that "The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors" (Section A6). Many public sector organisations have also followed the requirements of Section A6.

By institutionalising board appraisal, the Combined Code not only changed the rules, but also changed board member attitudes. The option had became the requirement, so it's not completely surprising that some treat board appraisal as a constraint, to be overcome as quickly as possible.

Just as the requirement for board appraisals was part of the tightening of UK corporate governance standards in response to highprofile scandals, in the US similar moves were prompted by events at Enron and WorldCom. The result, as in the UK, included a requirement for appraisals. Countries such as South Africa and Australia have gone further than the US. In continental Europe and Asia too, there have been pressures for better governance, though the effects have been less marked because of a combination of more traditional ownership and different institutional structures.

International judgements and board appraisals have to be seen in the context of institutional, cultural and other differences. In the US, for example, the fear of litigation 'hangs over' board appraisal as it does over so much else in corporate life. One example is the perceived danger that board appraisal output could be disclosed to the opposition as part of a 'legal disclosure' process. In many cultures, issues of 'saving face' mean that criticism has to be handled very differently to an Anglo-Saxon approach.

The framework outlined below is set in a UK context, though the principles are applicable more widely. It's designed to ensure that everyone involved understands what success means and the measurement issues involved.

MEASUREMENT ISSUES AND HOW TO DEAL WITH THEM

To decide whether a board appraisal is a success, a number of measurement issues need to be addressed. Three are crucial: decide what you are trying to achieve, interpret the evidence and measure the right things. These, and the actions to be taken, are set out below.

1. Decide what we are trying to achieve

The first question to be addressed is 'success for whom?' Not all stakeholders want the same things – the Chairman may want to review the balance of skills and experience, the shareholders could be looking for a major shake-up.

Therefore boards are not always clear what's being measured. Is it compared to what they are told to do, what they set out to do, what others are doing, or best practice? Perhaps it's a combination of all of these. Many board appraisals start with vague or unstated objectives. But if a board doesn't know what it's trying to achieve, how would it know it had succeeded? The starting-point is therefore the board agreeing its own objectives. These will probably include items common to most appraisals, such as that the real issues have been addressed and that the agreed recommendations will be carried through. The objectives also need to bear in mind any publicly-expressed concerns about the board and specific issues which currently preoccupy it, such as the relationship between executive and non-executive directors. Spelling these out enables the board to have a common view on what they are trying to achieve.

The form of an appraisal should follow the definition of objectives, not the other way round. There are lots of permutations – internal or external; questionnaires, interviews or a combination of the two; the 'full monty' or appraisal-lite; feedback to

If things are going well, it's easy for boards to believe that they are doing a great job

COMMUNITY COMMENT

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For Board appraisals, the purpose of the exercise is to make a good board great. They should not therefore be considered an inconvenience – in fact, even those sceptics that think as such are usually won over by the end. In terms of ownership, the chair should feel completely this it is his/her exercise. He/she should see the penultimate draft, should ensure that it has no attributable comments and should consider it useful to interview the principal stakeholders outside the Board, including the Company Secretary, in its preparation."

MEASUREMENT ISSUES AND WHAT TO DO ABOUT THEM

What we are trying to achieve

Issues:
- Clarifying who will be defining success
- Identifying the relevant comparisons

What to do:
- Agree objectives, then decide the form of the appraisal
- Make sure the Chairman sets the right tone

Interpret the evidence

Issues:
- Understand the limitations of questionnaires
- Interpreting disagreement

What to do:
- Separate the success of the organisation from the board
- Use a trusted and empowered insider, the non-executives and/or outsiders

Measure the right things

Issue:
- Be aware of the danger that the process and the 'numbers' may dominate

What to do:
- Emphasise the qualitative through comments and interviews
- Focus on measuring action

the whole board, to individual directors or both. For example external appraisal is more likely to be appropriate if the board has major issues of dynamics to resolve. If there are no such major issues to resolve, better to go for a full appraisal every three years, with a lighter touch in between.

The Chairman has a crucial role in raising commitment and reinforcing the objectives by giving an unambiguous message, that it should be taken seriously and that action will be taken on what emerges. Implying that it's all a 'bit of a bore,' or that nothing will happen is definitely to be avoided. If it's the first time that an appraisal has been done, it's particularly important for the Chairman to allay fears about hidden agendas.

2. Interpreting the evidence

As in all good detective stories, a lot hangs on the quality of the evidence. Filling in questionnaires which cover such things as membership, skills, processes, relationships, coverage and impact, gives clear and checkable information but getting the best out of an appraisal will mean giving colour to the checklists of whether the board member is satisfied. This raises questions about the quality of the feedback, particularly if the whole process is done internally. This is tricky territory. The opportunities for cross-checking are limited and judgments may be difficult since everyone involved has an interest in the outcome.

There is also the question of how to interpret disagreements or the lack of them. It could be a successful appraisal if everyone on the board is reported as happy with the way things are, and no action is proposed. It could be that the board is self-satisfied and performing well below its potential.

Now let's suppose the opposite. The board as a whole disagrees with the recommendations. Is this an unwillingness to confront difficult issues or a poor appraisal? And what about divisions among board members about the recommendations? Dissent about results is not uncommon and can lead to fruitful discussions about the issues involved. But arguments might signal fundamental divisions.

There are a number of ways to tackle issues of interpretation. Using a trusted and empowered insider who is not a member of the board – for example the Company Secretary – is one. This can work if the insider really is trusted, has personal authority combined with acknowledged integrity and if there is absolutely no suspicion that there will be leakage of confidential remarks. Trust is important even if there is apparent harmony – board members must feel free to express what they think. If there are any concerns about using the Company Secretary from anyone (including the Company Secretary) he or she is best deployed when there are only questionnaires, preferably anonymous, from a large enough group to avoid the danger of identifying individuals.

Using the non-executives to provide an outside perspective is another way to help with interpretation. They have an incentive to make sure the appraisal process is a success. Of course it's satisfying to be part of a high-performing team but if everything goes horribly wrong, their reputations will be on the line. Comments can be particularly valuable from those who have just joined the board. They may be reluctant to upset the status quo, so will need to be encouraged by the Chairman. All non-executives' views should in any case be sought before the process starts and as part of a review at the end.

Bringing in outsiders is the most straightforward way to deal with questions of evidence. What they can offer is not only an independent perspective, but also experience of best practice in other organisations. These advantages have to be traded off against cost, the danger that they will not understand the organisation as well as insiders and any potential conflicts of interest if they offer additional services. A judgment about balance has to be made here. The balance can be improved by not having a full appraisal every year (with lighter-touch or internal appraisal in between) to reduce the cost, continuity of outsiders (to reduce the learning element, while making sure they do not get too close) and bringing any potential conflicts of outsiders' interest into the open.

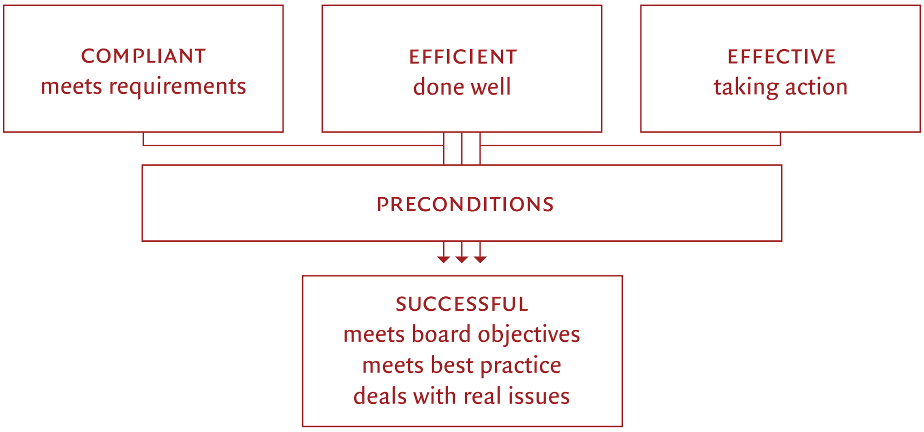
The form of an appraisal should follow the definition of objectives, not the other way round

3. Measuring the right things

A great deal of what is covered by board appraisal isn't easily measurable. Whether board members turn up is fine, but how do we capture the subtleties of board dynamics and the quality of decisions? Measurement here, as in so many areas, has a tendency to be skewed towards what we can easily measure. Process – numbers of meetings, what's on the agenda, induction for new members – can dominate.
Here too, the role of questionnaires is in the spotlight. While valuable in identifying the issues for discussion, number-based answers mustn't be given too much significance, with changes between one appraisal and the next taken as indications of success and failure.

The most straightforward way to take numbers in perspective is to make sure they are balanced by the qualitative element of the appraisal. These will come from the comments that supplement box-based answers in written questionnaires and the feedback from individual interviews. Both give depth to the appraisal process and the Chairman, in steering discussion about the results, needs to give them appropriate weight.

The Appraisal – From Compliance to Success



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The other key element in measuring the right things is to focus on monitoring action. What's in the action plan needs to reflect the complexities of behaviour, such as the quality of decision taking and the cohesiveness of the board. For these to come out, the action plan needs to be framed and discussed in a way that enables such nuances to be brought out.

Agreeing an action plan will be valuable in its own right. Even more valuable will be timing the actions so that progress can be reviewed at relevant intervals, say after three and six months. Has the Chair's handling of sensitive matters really improved? Are outside investors more convinced about the board's ability to handle current issues? The board should check them out.

WHAT IS SUCCESS?

Addressing the above measurement problems is essential to improve the chances of being able to measure the success of the appraisal. This is because a board appraisal that complies with any external requirements, that is done efficiently and that is effective in translating findings into action provides the preconditions of success. But for an appraisal to be successful, it has to pass three tests.

The first is that it meets the objectives set by the board. Without doing so, an apparently good management process will fail the test of meeting what those with most at stake – the directors – want it to do. If, for example, one of the key objectives is to take a good look at whether board meetings are covering the right issues, addressing this must be part of a successful appraisal process.

Then there's the tougher test – that of matching good practice elsewhere. A board may be satisfied enough with what it has achieved, but it has to know that it is matching what other similar appraisals are offering. An example of good practice would be, the first time an appraisal is conducted, to involve board members in deciding how the appraisal is to be conducted to help assuage fears and overcome barriers. Another would be to seek to anticipate problems and not be entirely reactive. Outsiders, including the nonexecutive directors, can provide information about what is going on elsewhere.

Finally there is the judgement that the appraisal has dealt with the real issues – the proverbial elephant in the room. Examples might be a tense relationship between Chairman and CEO or non-executives worried they don't know what's going on. Such issues may not be set out in the objectives because the board may not be aware of them or may not be willing to put them on the table. Rather they may only emerge during the appraisal process, and this has to be able to accommodate and help to resolve them.

The framework is set out in the chart above and the Crunch Questions on the right.

CONCLUSION

When all is going well, it's easy for boards to believe that they are doing a great job. When all is going badly, it casts doubt on everything, including the way the board works.

Of course the two are not the same. A great board is one that steers the organisation through the bad times. Some poor boards are blessed with what Napoleon wanted his generals to be born with, a lot of luck. Understanding what success means for an appraisal can help to make sure poor boards don't run out of luck and that good boards get better.

THE CRUNCH QUESTIONS

For compliance – Have we done what we were supposed to do?

For efficiency – Was the process done well?

For effectiveness – Will the issues identified be addressed?

For success – Are we compliant, efficient, effective and:
- Have our agreed objectives been met?
- Have the essential issues been identified?
- Does the appraisal match best practice?

But appraisals cost – money if outsiders are used and valuable time of the organisation's key decision-takers. So like every other management process, they should be assessed for the value they offer and offer lessons to learn for the next time. Measuring success is an essential element of ensuring organisations make the most of what an appraisal has to offer.

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