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Board Evaluation – A Critical Analysis

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Abstract: **The Board, its composition and its performance evaluation is critical to corporate governance. Board evaluations can bring extraordinary benefits to the organisation and well conducted performance evaluation of the board will lead to significant improvements at each level of the organisation. A well defined and effective process of board evaluation will provide a positive note and will add value to the organisation as a whole. This article reviews the evaluation contents, frequency, methods and techniques. A critical analysis is made with respect to risks and challenges associate with board evaluation. Since boards vary in various institutions across the world, a uniform or acceptable framework for evaluating board performance is challenging**

***Index Terms*: corporate governance, evaluation, board**

I. INTRODUCTION

The increase in corporate failures and financial losses suffered by investors, there have been public outcries and demand to make board more accountable for the performance of the company. Public sees the role of the board is to practice good corporate governance to ensure an effective and transparent system is in place to manage a company, with the aim to achieve firm performance and add value to shareholders. Board members are now pressured to comply with regulations and statute laws, and be more diligent and to act with duty of care when carrying out their responsibilities. They are ultimately responsible for the performance of the company. As such, board has to be continuously effective in their functions to meet these challenges. One of the techniques to ensure board continuously improve its performance is board evaluation. This article will focus on the processes of the board evaluation and a critical analysis.

II. LITERATURE REVIEW

Board evaluation can be defined as a tool used to evaluate the board, its committees, and individual directors, to assess the effectiveness of their performance in ensuring key objectives of the company are met (McCormick 2012).Effective board performance can be interpreted as being able to provide a process of transparencies in the decision makings, setting relevant strategic directions of an organization, providing advice and mentorship to management, and close monitoring on the performance of management and the organisation, with the long term objective of financial sustainability and business continuity. Combining all these together will create good corporate governance (Tricker 1987).

Some notable benefits that can arise from board evaluation, if applied correctly, include:

- Each director is clearer on their respective responsibilities, and their areas for improvement (Beck & Watson 2011; Kiel & Nicholson 2005);
- 87% of the boards agreed that there have been positive team performance as a result of board evaluation (Curtis 2007). This is further supported by the survey done by PwC in 2010 that 65% of boards became more proactive in their practices and decision ('Malaysian Code of Corporate Governance 2012);
- Enhance board and stakeholders relationships, as well as communication and expectations with stakeholders and management (Beck & Watson 2011; Conger, Finegold & Lawler III 1998; Kiel & Nicholson 2005).

According to Conger, Finegold & Lawler III (1998), board evaluation is slowly gaining popularity as a tool to improve board performance. About 20% of companies in USA have some sort of board evaluation process in the early 2000 (Ingley & Van der Walt 2002). This figure jumped to over 90% in 2011. However, less than half actually conducted performance evaluation on individual directors, and only 20% used external expert for the review (Gwin & Vavrek 2011). The increase is largely due to the New York Stock Exchange requiring public listed companies to have board evaluation since 2004 (Dierickx 2005). Board evaluation can provide an invaluable insight for members into their collective strengths and weaknesses (Kiel & Nicholson 2005). However, there is great resistance to fully implement the system due to the sensitivity of the results and consequences, in particular to underperforming members. Whether the tool can be used effectively to promote board performance is highly dependent on the cooperation of board members to embrace its purpose (Daily & Dalton 2003; Ingley & Walt 2002; Long 2006).

Board evaluation is a challenging process to manage since it involves senior members of a corporate (Ingley & Van der Walt 2002). A framework for board evaluation would be the first stage in identifying the process. Both Kiel & Nicholson (2005) and Minichilli, Gabrielson&Huse (2007) posed several questions to ensure the board evaluation process has the integrity to function effectively.

There are various methods in board evaluation. The identification of which method would suit the modern day board may depend on several factors.

Self-evaluation

Self-evaluation is conducted by the board members themselves. The assessment can either be for the board as a whole or on individual director. This method of assessment is purely for internal consumption, and it is meant strictly to enhance the performance of the board on its processes and tasks, without having to divulge information to the shareholders (Minichilli, Gabrielsson & Huse 2007). However, self-evaluation may also be opened to biasness, as different experiences of the directors will influence their choices and perceptions of the subject matters (Gwin&Vavrek 2011).

External consultant to conduct the assessment

The board evaluation can also be conducted by an independent external expert consultant. This method is deemed to be the most objective pathway to conduct board evaluation. The consultant must have the sufficient experience, knowledge and skills to conduct an effective board evaluation (Conger, Finegold & Lawler III 1998; Gwin & Vavrek 2011).External consultants may have access to benchmarking information which can be useful to determine the performance direction the board wishes to take. Benchmarking can only be useful if sufficient data is available. Further considerations should also be made in regards to similarity of industries, and the stage of progress of the company (Beck & Watson 2011).

Peer and stakeholder review

The board evaluation is conducted by a peer director and a stakeholder. Kiel & Nicholson (2005) deemed peer review may be more objective compared to self-evaluation. They further suggest that this method provides a more comprehensive evaluation on individual directors' strengths and weaknesses, and can assess board dynamics. However, Curtis (2007) argued that peer review may adversely affect group unity and create tension among members, if there are unfavourable outcomes from the assessment.

External review done for external stakeholders

This method of board evaluation is conducted solely external to the company. It can reduce impartiality, enhance objectivity and integrity, and add credibility to the company. This method also allows useful benchmarking with other companies to gauge the board performance (Minichilli, Gabrielson&Huse 2007).Board members should play a critical role in their own assessments (Conger, Finegold & Lawler III 1998). However, the self-evaluation method is fraught with issues of the individual director being able to conduct it objectively. This is highly subjective and may lack the credibility to truly identify any potential weaknesses (Kiel & Nicholson 2005). Thus, the benefit of being able to continuously improve board performance is not realised. However, a way forward to improve this method is to conduct the self-evaluation anonymously. This way, the individual directors may be more receptive to open up to their areas for improvement.

Thus, in reviewing the above analysis, we would opt for a hybrid method. We would recommend that an anonymous self-evaluation and to engage external consultant be made as a cross and check balance. This method will enhance the objectivity and integrity of the board evaluation process, and at the same time, provide directors with an opportunity to make their own assessments.

Contents of evaluation

The contents of evaluation have evolved significantly over the years, from prescriptive base to more dynamic open ended questions, with a combination of quantitative and qualitative approaches (Beck & Watson 2011; Daily & Dalton 2003; McCormick 2012). This can also reduce some levels of biasness (Kiel & Nicholson 2005).There have been debates on the contents of the evaluation. But several key areas are usually centred on leadership, board culture, board composition, and performance objectives (Long 2006; Minichilli, Gabrielson&Huse 2007).

We agree that the contents of the board evaluation should entail both quantitative and qualitative approaches to ensure the system is sufficiently robust to address any areas and challenges the directors and board may face.

The audience

There are several stakeholders who would be interested in the outcome of board evaluation. They may include the board themselves, shareholders, regulators and researchers to name a few. These parties would have some vested interests in the ability of the board to perform, and ultimately be financially sustainable (Minichilli, Gabrielson&Huse 2007).

Currently, the results of board evaluation are not required to be shared with stakeholders. Public listed companies are only required to describe the process adopted in their annual reports (Beck & Watson 2011).This is largely due to the sensitivity of information and possible legal implications board evaluation may entail (Muir 2013).

We agree that details to the outcome of the board evaluation should not be shared, with due respect to the directors' privacy, given their usually high profile. However, details of the board evaluation process should be shared to ensure the system is sufficiently robust.

Evaluation Approach

The methodologies to be adopted for board evaluation are important to be able to sufficiently ascertain the strengths and weaknesses in its performance. According to Minichilli, Gabrielson&Huse (2007), some of the methodologies may include:

- Interview based – this may be in the form of open discussions among members, and personal interviews which may be conducted by external consultant or the board chair;
- Paper/web based – develop a standard questionnaire. This method is commonly used by external consultants, allows for data gathering and used as benchmarking over the years;
- Observation of board and committee meetings - either conducted by internal or external parties. This is considered to be the least invasive and is a useful method to assess the behaviours of members in action;
- Document analysis – this include the review of the minutes of meetings, policies and guidelines approved by the board, and any other relevant documents.

The most common methodology used is the paper/web based standard questionnaire for board evaluation. Even though both the quantitative and qualitative approaches can be included in this method, it lacks the human touch of being able to discuss with board members on their performance. Observations are also useful in determining board dynamics and team work. This is also supported by Kiel & Nicholson (2005). Thus, I would recommend for all the methodologies above to be incorporated into the board evaluation process to enhance its effectiveness.

Frequency of evaluation

The New York Stock Exchange Listing Standards and the UK Combined Code on Corporate Governance (Financial Reporting Council 2003) require public listed companies to conduct board evaluation annually (Long 2006; Taten & Barker 2004). Annual board evaluation is the most commonly cycle adopted, which is usually aligned to the company's strategic planning (Kiel & Nicholson 2005).
However, there are many companies that practice periodic assessment of 2-3 years as it is deemed to be more viable as board evaluation is a tedious and time consuming affair (Kiel & Nicholson 2005; Taten & Barker 2004).

We support for board evaluation to be conducted every 2-3 years. This is due to the fact that board may not meet as frequent, and to make assessment based on their contributions over just a handful of meetings seem unjust. In addition, too regular an assessment will become a chore rather than a useful tool to help board and its members to perform better (Kiel & Nicholson 2005). Members may be distracted with internal processes as a result, rather than focus on the challenges that the company is facing. In addition, annual assessment is a costly affair, in both time and money (Long 2006).

Outcome & action

The outcome of board evaluation is the most valued part of the exercise. The action to take by the board to address areas for improvement is crucial to the entire process of board evaluation (Gwin&Vavrek 2011). If no action is taken, which is often the case, then it becomes pointless to even consider doing board evaluation (Beck & Watson 2011; Daily & Dalton 2003).
The ownership of the board evaluation process must lie with the board itself. Thus, the board should be proactive to instigate a review of its performance on a periodic basis and to do a follow up of the previously proposed actions. This is to ensure that the board remains vigilant and responsive to its strengths and areas for improvements (Beck & Watson 2011; Daily & Dalton 2003; Jaeger 2011).

Based on the analysis above, we strongly agree that the board needs to own the evaluation process, and follow ups should be initiated by them. This is to ensure effective implementation can be carried out and progresses are monitored.

III. RISKS ASSOCIATED WITH BOARD EVALUATION

It is all good to conduct board evaluation to improve performance. However, the board must have the hindsight on the potential risks in adopting board evaluation process. The risks may include:

- potential liability for legal suits if board or its members are underperforming - Litigators may take advantage of the good intentions of the company by using the documented evaluations outcome as evidence for their case (Curtis 2007; Daily & Dalton 2003; Kuprionis 2011; Taten & Barker 2004);
- can adversely destroy trust and relationships among its members (Ingley & Van der Walt 2002; Kuprionis 2011);

- can increase the costs of doing business – the need to comply with statutory reporting requirement, frequency in conducting board evaluation, and the need to engage external consultant will increase the costs of doing business (Daily & Dalton 2003; Muir 2013).

Formulating a board evaluation process to mitigate the risks and yet be able to reap the benefits of it is crucial. As proposed by Daily & Dalton (2003) and Taten& Barker (2004), the board and its members should be safeguarded against the risks. Taten& Barker (2004) suggest the following can be considered when formulating board evaluation process to mitigate such risks:

- Written / verbal evaluation – this is for the board to consider whether to have a paper trail or otherwise. The board need to make its own assessment so as not to expose the organisation to unnecessary legal liability (Schnase 2004);
- Retention period of documents – can range from 30-90 days. It is advisable to shred all documents after this period. Daily & Dalton (2003) also support the need to strictly follow the retention period policy;
- Anonymous evaluations – this is to keep the identities of directors protected and to encourage constructive feedback;
- Legal vetting of process and documents – to vet through the board evaluation documents to protect the interest of the company;
- Summary of report outcome – findings of board evaluations on strengths and areas for improvements. The report can be recorded as proof in the minutes of board meeting that an evaluation has been conducted.

IV. CHALLENGES WITH BOARD EVALUATION

There have been constant debates on the number of challenges surrounding board evaluation. These challenges may include:

- the effectiveness of conducting board evaluation – there is no one ideal method that can suit all boards in conducting their own evaluation as certain aspects of board effectiveness are difficult to measure and quantify (Ingley & Van der Walt 2002);
- the need to appraise individual directors – since each director's contribution to the organisation varies, depending on their expertise, background, and external connections, it is difficult to appropriately measure them (Conger, Finegold & Lawler III 1998; Ingley & Van der Walt 2002);
- the need to engage external consultant to conduct board evaluation – whether external consultant can effectively conduct board evaluation and review its processes, as well as having the necessary business understanding to do so (Dierickx 2005).

V. FINDINGS AND RECOMMENDATIONS

Most literature materials support the need for board evaluation despite the challenges and issues raised. Based on the analysis from the various literature read, board evaluation is not meant to be able to resolve all challenges that each organisation may face. However, board evaluation can provide an insight to its strengths and weaknesses, with the objective to continuously improve its performance in meeting the increasing regulatory demand and expectations placed on its members (Minichilli, Gabrielsson & Huse 2007). The board evaluation process should be dynamic and periodically reviewed to accommodate best practices.

Given the sensitivity and high profile of board members, as well as the risk associated with board evaluation, a web based process with confidentiality of information and identities protected, should be considered. The evaluation should be conducted periodically, depending on the complexity of the business. The process should also be evaluated by an independent expert consultant. This is to ensure the process remains relevant and continues to meet the objectives of the evaluations (Conger, Finegold & Lawler III 1998). In summary, from the literature reviews made, the following processes can be considered for a board evaluation to be conducted:

- Web based anonymous self-assessment of directors, the board, and its committees. Questionnaire should include qualitative and quantitative approaches (Daily & Dalton 2003);
- Engage external consultant to conduct interviews and observe the board and committee meetings, and review the board evaluation process (Conger, Finegold & Lawler III 1998);
- Review related board documents to supplement the evaluation (Minichilli, Gabrielsson & Huse 2007);
- Conduct the board evaluation every 2-3 years (Taten & Barker 2004);
- All documents related to board evaluation must be vetted by the company lawyer, to ensure some safeguard system has been built into the process (Taten & Barker 2004);
- Retention of evaluation documents, preferably up to 90 days only. After that, all documents should be

shredded (Daily & Dalton 2003; Taten & Barker 2004);

- A summary outcome of the board evaluations outlining key strengths and weaknesses. Only this summary report is kept as a record of the process (Taten & Barker 2004).

VI. CONCLUSION

Board evaluation is a new technique being used globally both by public listed companies and private companies, to ultimately improve corporate governance and performance. The effectiveness varied as a result of the implementation of the process is not fully adopted. This is mainly due to the sensitivity of the outcome, and the risks associated with it. However, if the process is carefully formed with the objective to continuously improve board performance, and yet be able to safeguard them against potential risks, great benefits can be realised (Daily & Dalton 2003; Taten & Barker 2004). With continued demands being placed on board members, it is anticipated that board evaluation will increasingly become an important feature in an organisation to continuously improve its performance (Kiel & Nicholson 2005). Due to the complexities and variation of boards across the globe, it is extremely challenging to determine an acceptable framework for board evaluation, and this remains a grey area for further research to be explored.

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