

BOARDS

¶207 Assessing individual director performance

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A SX Corporate Governance Principle #8: Encourage enhanced performance — says that “individual and collective performance regularly and fairly reviewed”.

Judging by the absence of reaction so far, it would seem that there is broad agreement with this principle; that is, governance best practice should include performance reviews not only of boards as a whole, but also of individual directors.

Do boards and the market really agree with the review of individual director's performance, or is Principle 8 such a “motherhood statement” that we've not given it rigorous analysis?

In light of the establishment by the ASX of an independent review group to revisit the guidelines, it's worth looking more closely at this issue. Firstly, we do believe that performance reviews (and the ASX Principles) are a good thing but both need to be grounded in solid thinking. Almost all that we know about individual performance reviews has been learned in the arena of full-time employees, and many critical aspects of these sorts of reviews simply don't apply to boards and directors.

There are three elements that underpin full-time executive performance assessment:

- (1) there is a source of authority (the boss) that is accountable for defining the executive's role and responsibilities;
- (2) there is a (relatively) well-defined description of what is expected; and
- (3) there are measurable and qualitative indicators of whether that expectation is being met.

So the first problem is “Who is the boss of the board member?”

Many directors say that they would like more feedback on their contribution and performance, and they frequently nominate the chairman as the person they expect that feedback to come from. We are by no means convinced of the merits of that solution. True, some chairmen assume this role as a matter of course — but many see their role as ceremonial and process-focused, as “first amongst equals”, and believe it would be presumptuous and potentially damaging for them to assess fellow directors.

Should chairmen fill the role of “boss”?

Directors (be they executive, non-executive and/or independent) are supposed to act as representatives of the shareholders. The very point of having a number of directors is to obtain different perspectives. And, at the extreme, shareholders expect them to exercise their capacity to remove a non-performing chairman.

To what extent should they therefore be held accountable to the chairman, and to what extent he/her to them?

Articulating what is expected of the director is the second challenge. Executives are primarily doers — accountable for the achievement of goals — many of which are measurable. Ideal performance is usually described at a number of levels, including a job description, eg “responsible for performance of divisional executives”; a strategic plan eg “focus on cost control and growth opportunities in emerging markets”; some measurable indicators of success eg “market share, ROI, share price”; and some qualitative indicators eg “maintain sound relationships with institutional investors”.

With some exceptions, directors are primarily there for their judgment, not for action and while we all want them to be diligent, it is far more difficult to find some hard indicator to measure — other than quantitative indicators such as meeting attendance.

Directors are also not all there for the same reasons. Not only do they bring different expertise, but they also take on different roles and fit into the board structure differently. Few organisations that we know of can claim a comprehensive statement of

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expectations of directors generally – let alone individually tailored ones. Finally, assuming that expectations are agreed, in the absence of “hard” indicators, how will we assess performance?

Some organisations use 360-degree feedback for their full-time executives.

Typically, 360-degree feedback is a means of supplementing the traditional performance feedback from “above” with the (usually anonymous) surveyed perceptions of one’s peers and immediate subordinates.

Supporters of 360-degree feedback cite the critical nature of the relationship with peers and subordinates in executive roles and the close perspective peers and subordinates have of an executive’s style.

Detractors oppose it for the risk of becoming a popularity contest or a free-for-all of unattributed and potentially unfair criticism. 360-degree feedback is an obvious technique to consider for director assessment given the essentially peer nature of boards, but like performance assessment generally, it is critical to note what is different about its application to boards.

First, it is not a “supplement” in the way that it is for executive feedback — rather it may constitute the whole of the performance review.

Second, where the chairman chooses not to assume a superior role, there may be no “downward” feedback involved. (270-degree feedback?)

Third, in most circumstances, there is little or no meaningful “upwards” feedback from subordinates. The CEO may be privy to all board interactions, but many other senior executives are only present for limited parts of board meetings. (180-degree feedback?)

Fourth, assuming we have solved those problems, we must remember that the peer perspective is based on much more limited and quite uneven exposure to each other (compared with the full-time executive’s experience) — some will only see each other as little as once every two months for a day, others will share committee duties or other

boards and business interests, and have spent many more hours working together.

Another critical difference between the executive management context and that of the board is that the social system in a management structure is bound together by common purpose, by defined and delineated roles, by hierarchy and employment contracts and obligations, and by a myriad of daily interactions.

Executives are expected to have very robust exchanges and considerable tensions exist within that social system.

A board’s social fabric is far more fragile — directors may only see each other infrequently, they have loosely defined responsibilities with considerable overlap and their ability to contribute and to disagree with each other depends critically on their ability to maintain a harmonious working relationship with each other.

This is not to say that individual director performance assessments are a bad idea.

On the contrary, they can reinvigorate a board and help to create a culture of critical self-assessment, performance awareness and continuous improvement.

The three pieces of advice we give our clients considering individual director performance reviews are:

- (1) Before you embark on the process, ensure you really understand how your board works and what the expectations of your directors should be.
- (2) Understand the assessment method you choose and its inherent limitations. Preferably do not rely on one diagnostic alone — seek out some way of corroboration.
- (3) Ensure that you know how you will use the performance feedback to constructively move forward. That means that the chairman at least is fully engaged in the process before it begins — don’t simply rely on your consultants or the HR department!

Finally, it is critical to remember that it is the board’s performance as a group that matters.