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Tesis doctoral

Defining a method to evaluate Boards of Directors efectiveness

Jaime Grego Mayor

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Defining a Method to Evaluate Boards of Directors' Effectiveness

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0. Foreword. Purpose, methodology and contents of this work

"*The light that a man receiveth by counsel from another is drier and purer than that which cometh from his own understanding and judgment, which is ever infused and drenched in his affections and customs*". Francis Bacon, *Of Friendship,* Essays (1625).

"*Boards aren't working. It's been more than a decade since the first wave of post-Enron regulatory reforms, and despite a host of guidelines from independent watchdogs such as the International Corporate Governance Network, most boards aren't delivering on their core mission: providing strong oversight and strategic support for management's efforts to create long-term value."* (Dominic Barton and Marc Wiseman, 2015).

Boards of directors are indeed pivotal in the governance of corporations, whatever their size, country or ownership structure. During the last two decades, they have received more and more attention from academics, practitioners, regulators, the media and even the general public. They have been considered responsible for many catastrophic failures, from Enron to Lehman Brothers to Wells Fargo, and many previous and subsequent corporate scandals, big and small. Examples from Spanish board failures come immediately to our minds, top among them, perhaps, the case of Bankia.

This attention and the increasing demands placed on boards are clearly justified. Boards are essential for improving corporations' governance, their performance, their value creation and for fulfilling the needs of companies' stakeholders, not just those of their shareholders.

Motivation, hypothesis and goal.

Improving board effectiveness through a better evaluation system.

As quoted above, “boards aren’t working”. This is the main reason motivating this research work. The fundamental hypothesis on which this dissertation is based is that corporate boards’ effectiveness can substantially improve through annual evaluations, which specifically and objectively measure the contributions made by the board to the company’s progress towards its strategic goals and performance objectives, whatever they may be.

The subject of board evaluations is particularly relevant today because it has the potential to become a key tool for substantially improving boards’ effectiveness and contribution to the companies they serve, and yet it is too rarely used in an effective way.

This study tries to explain the concept of evaluations, the procedures and techniques used, how they work and what results they achieve. And this from both a theoretical or academic point of view as well as from the practical reality perspective.

Through the research process (literature review), the ample survey (explained below) and several practical cases in which the author has been directly involved, this paper supports its main hypothesis, mainly that evaluations serve their purpose most effectively when clear and specific objectives are defined for the specific board of a specific company. There is no one-size-fits-all and the ex-post evaluation of generic objectives is significantly less relevant than evaluation against objectives set in advance. Each company is different, each one has its own ownership structure, each one is at a particular stage in its development, they have different stakeholders with different interest, seek different goals and pursue different strategies, they vary in size and by countries where they operate.

Boards, and therefore their evaluations, must work with specific goals in mind that reflect the unique circumstances of the company. In fact, the goals for the board have to align with and further those of the corporation and they must be objectively set. What board evaluations must assess is to what extent and in what manner the board assists the company it serves in advancing towards its strategic goals.

This dissertation aspires to offer a new perspective and method for making board evaluations the powerful tool they have the potential to be, through the new evaluation tool which adapts itself to each company and its board.

The inspiration for, and many of the conclusions of, this work come from direct experience in assisting corporations in designing and implementing an effective board. The hope is that through the systematic research of a wide variety of information sources combined with the extensive first-hand field experience, the new evaluation system proposed in this dissertation will help companies to exploit the full potential offered by this assessment tool.

Focus and methodology.

Special interest in SMEs and advisory boards. Literature research, international survey and real examples.

Many sources of information have been consulted, studied and analyzed. These include, among others, academic books and research works, articles by experts, and reports from consulting firms which portray an accurate picture of the current reality of boards and their evaluation practices.

The work focuses on evaluation theories, methods and techniques proposed by the different experts. It deals too with the current practices of companies performing evaluations and to what extent they are effective, meaningful and useful.

Small and medium sized companies (SMEs) are of particular interest, since they represent the highest percentage of companies in almost every country in the world. The contribution of SMEs to wealth and employment creation is crucial to the global economy. This is even more so in the case of Spain, which constitutes another special interest of this research work.

Closely related to SMEs and family owned companies is the concept of advisory boards. Advisory boards -which do not have executive power, do not make decisions and are therefore much less liable for a company's decisions- are nevertheless a very useful means for advancing SMEs towards their strategic goals and improving their performance. The advisory board becomes particularly useful when the company is going outside its "comfort zone", expanding into new markets, products or services or

with specific issues to face, such as a generational transition of CEO and top management positions or the addition of strategic or financial investors.

Board evaluations have been the subject of many studies, analyzed and considered from a wide variety of perspectives. Nevertheless, in the real world, they are still much underutilized, perhaps because they generally do not serve the purpose nor achieve the goals they should.

The path followed to prove the initial hypothesis includes -as already pointed out- the study and analysis of a substantial number of written information sources. More importantly, it is also based on an extensive survey, undertaken between 2014 and 2017 by ABA (Advisory Board Architects), a consulting firm of which the author is a co-founder.

This survey was carried out by means of a questionnaire administered to 397 business owners and board members from all over the world. The questionnaire presents a series of questions regarding boards, whether the company would choose to have a board of directors given the opportunity, what type of board they have or would like to have, with what features and role, whether or not boards are evaluated, with what frequency and to what purpose, and so forth.

The geographical scope of the survey was wide, including companies from North America (USA, Canada and Mexico); European companies from Central, Southern, Eastern and Western Europe; Central and South American companies; as well as firms from South and North Asia and the Middle East.

The sample focused on small and medium sized companies (from 1-50 employees to 101-500 employees) and large corporations (over 10.000 employees).

This work is also based on hands-on direct experience with the setting-up of boards in specific companies, recruiting the most suitable candidates for the work at hand, establishing board's procedures, following up on board meetings, preparing board packages for each session, performing the annual evaluation and processing its results, and finally deciding on improvement measures -which may even imply the dismissal or replacement of a director- and determining the goals for the future. This dissertation presents detailed examples of real life boards, their goals and evaluations performed.

Structure of this dissertation

Need for improvement. Theory. Practice. Effectiveness. The new evaluation method.

This work starts by establishing the fact that there is great need to enhance boards' role for them to exert the right strategic impact on their companies. The reasons for current failures are examined in **Chapter I**. They include such factors as boards' lack of expertise and knowledge of the industry; failure to perform the oversight function of their role, since often directors are too complacent and do not question top management decisions. Another top driver of boards' lackluster -or, in many cases, plainly poor-performance is the excessive emphasis on short-term results -a general tendency in today's business world- and the scarce attention given to long-term value creation. These realities have resulted in higher scrutiny and increasing pressure on boards from institutional investors, stakeholders in general and regulators. Academic experts and practitioners in this field are also demanding better corporate governance practices, that boards be held accountable for their failures, and that board evaluations serve the purpose of improving board performance.

The **second chapter** deals with the importance of small and medium sized companies, given the fact that they contribute greatly to the economy of most countries in the world. First, SMEs are defined in terms of their number of employees, turnover or balance sheet total. A separate section deals with SMEs in Spain and another one is devoted to the particular features and issues faced by family owned business. SMEs can derive special advantages from implementing a board. These benefits include promoting and accompanying growth, generating accountability and institutionalization of decision making and helping to keep a company on its strategic path. The following section of the chapter describes the role of boards of directors in SMEs, emphasizing the fact that they can be key contributors to their performance. It also touches on the factors which are likely to drive the implementation of a board. These include such aspects as the owners' level of education, the complexity of the family, the generational transition, etc. Chapter II then goes on to discuss board composition in SMEs and board empowerment and, finally, it describes the various types of board a small or medium sized company may implement: private boards with a fiduciary duty (not very often used); advisory

boards, which are the more widely recommended option; and alternative boards which offer the benefit of being useful and affordable.

The next chapter, **chapter III** of this work, is devoted to the various evaluation theories. First it discusses the concept of evaluation which most public traded companies perform annually, nowadays, with apparently little effectiveness. It then goes on to analyze in what ways and to what extent board theories include evaluations as part of their perspective. Agency theory, Stewardship, Resource Dependence Theory and Stakeholder Theory are reviewed to conclude that all of them pay relatively little attention to board evaluations and their potential benefits. Moreover, the fact that they generally focus on just one aspect of boards to the exclusion of the rest clearly limits the practical application of these theories on a stand-alone basis. None of them considers the possibility of setting objectives for boards and regularly –annually at least – measuring results obtained.

The next section of the chapter reviews the literature contributions to the subject of board evaluations. It describes the point of view of theorists and researchers such as Kiel and Nicholson, Susan Schulz, Huse and Gabrielsson, Janicke Rasmussen, and Cohn and Kess. They all present their point of view about the key issues related to board assessments. Kiel and Nicholson propose an evaluation framework based on asking seven fundamental questions. Susan Schultz puts the emphasis on evaluation questionnaires. Huse and Gabrielsson highlight the concepts of report, recruitment and development. Janicke Rasmussen proposes using the question of *value for whom?* as the starting point and then goes on to assess board performance and conformance to content and context. Finally, Cohn and Kess structure evaluations around the common issues of board composition, time allocation, quantity and quality of information, management oversight, control and compliance and so forth. However, they bring to the table a new additional dimension to be taken into account by evaluations: board culture and dynamics, since they can significantly affect its performance.

This section of chapter III also includes the more practical perspective of consulting firm Deloitte. Their report highlights their view of the three top functions of any board: providing strategic direction for the company, management control and monitoring, and providing support and advice. Evaluations should thus examine these roles and how effectively they are performed.

Current evaluation practices are studied in **chapter IV** through the findings of a series of reports and surveys undertaken by prestigious consulting firms such as Deloitte, PwC, McKinsey & Co., Korn Ferry or Spencer Stuart. They review, among other topics, board composition, board culture and dynamics, board's strategy implementation, board workload, board training, board members' expertise and capabilities, and board evaluations. Some of them focus on European companies, others on American ones (USA and Canada). Particularly interesting is McKinsey's classification of boards in three categories: *Ineffective Boards*, *Complacent boards* and *Striving boards.* Overall, these reports conclude that there has been progress in the functioning and effectiveness of boards, but there is still great room for improvement. Regarding evaluations, they all agree that it is nowadays a well-established practice, quite more so among publicly traded companies, since evaluations are required by law. According to one of the reports, the number of Canadian companies conducting board evaluations has grown from 67% of the sample companies in 2014 to 80% in 2016. Nevertheless, board assessments are frequently a mere exercise in compliance with limited effects on board performance.

The chapter goes on to review the real evaluation practices of concrete companies, based on the information disclosed on their published Annual Reports. The sample chosen is limited but sheds light on how companies -some of them well respected for their governance practices- stand regarding board assessments. The first two examples include the top-ranking firms in good corporate governance in UK and USA, respectively -British American Tobacco Plc. and Microsoft Corporation. The third presents the case of the Anglo-Swiss company Glencore, one of the world's largest mining and commodity trading company. Then, the Asian perspective is included through the examples of SATS (Singapore) and Infosys (India).

This section is followed by one specifically devoted to Spain, describing the evolution of boards, corporate governance issues, the improvements achieved in recent years and what remains to be done. This section on Spanish companies also features some examples from Ibex 35 (Spain's large-cap market index) top companies and what they do as far as board evaluations are concerned. Banco Santander and Iberdrola were chosen as best practice examples; Indra and, most in particular Mapfre, as cases of very poor practices, based on the information they publish about their board assessments. Finally, this fourth chapter concludes with an illustrative example of a questionnaire

(the most frequently used tool in board evaluations). It is presented as an example of an excessively detailed instrument which does not particularly advance the practice of effective board evaluations.

The effectiveness of current evaluation practices is reviewed in **chapter V** of the dissertation. Here, the work turns once again to the theoretic domain. It starts with a discussion about the difficulties encountered when trying to implement board evaluations. Factors such as board reluctance, in particular, incompleteness and lack of appropriate information, lack of guidance from regulators, or board dynamics, which are frequently not taken into account, but nevertheless affect the effectiveness of boards' work, are discussed. The chapter goes on to describe effective evaluation examples cited by literature. The design and customization of board evaluations is explained in the following section of the chapter. The Balanced Scored Card from NACD (National Association of Corporate Directors, quantitative (surveys) and qualitative (self - evaluation, peer evaluation and the use of third parties) techniques are also described and their limitations highlighted. Authors insist on the need to use a systematic and comprehensive approach and they all agree on the necessity to set specific goals for board evaluations and to derive action plans from the assessment's results. They also recommend combining quantitative and qualitative techniques to obtain a more accurate picture of the effectiveness of the board work.

The final section of the chapter focuses on the shortcomings of current practices. The fact is that what most board assessments do is to study the traditional aspects related to board functioning. They consider its composition (with special emphasis on the number of independent directors and the board's diversity), its processes (number of meetings, information received and so forth), the fulfillment of the oversight and compliance function, as well as the risk management and strategic functions. All of these are important aspects and they certainly impact board work. Nevertheless, overall, board evaluations do not measure the effectiveness of the board in terms of strategic goals achieved or not, and specific contributions to the company's performance. It is impossible to evaluate without clearly set and measurable objectives set by the company -as a function of its own specific circumstances, purpose and ambitions- for itself and its board. The way they are implemented today board assessments serve mainly to benchmark boards against best practices but do not measure their contribution to their companies' progress.

Chapter VI presents the new evaluation system proposed by this work. The method is described and real practice with real boards is presented in detail. Overall, when goals are set for board evaluations they are defined as board evaluation goals and not as objectives to improve company performance and advance its strategic goals. Thus, more often than not, board evaluations end-up simply assessing compliance.

Drawing upon the evidence presented in this dissertation, this chapter identifies three key qualities that a board evaluation process must have to be effective. Evaluations must be: systematic, objective and specific.

It then goes on to describe the method proposed and to benchmark it against these three qualities. Guidelines are provided for the essential elements required to make the process work.

The chapter includes three real life examples of one company operating in the health care industry; the second, a home appliances retailer; and the third is a private equity fund. For each firm, a summary is included explaining the company's specific situation, its main strategic goals at the time and results obtained through the implementation of the board, as measured by evaluation parameters. Following this summary, all relevant documents pertaining to the company are included in a detailed version. They clearly show how the proposed method works. Chief among these documents are the Evaluation of the board´s performance and review of the Board Charter, specifying the quantitative results of KPIs (Key Performance Indicators) and the qualitative process variables. It also specifies the cost of board implementation and functioning and the board's ROI, which is usually very high.

Finally, **chapter VII** synthetizes the conclusions of this work and aspires to open new venues for advancing the practical implementation of effective boards and boards' evaluations, which serve the purpose of improving companies' performance and creating long-term value for them and their stakeholders.

The various theoretical frameworks studied in this work regarding boards help to understand reality but usually their focus is narrow, since they tend to concentrate on the compliance function of boards. This is particularly negative for small and medium sized companies. SMEs could obtain great benefits from high impact boards and less from merely complying boards.

The author's experience is testimony to this fact. The type of high impact board described in chapter VI adds great value to SMEs, especially when they find themselves moving in new strategic directions.

Applying the new framework proposed by the author has allowed boards to rapidly focus on what was important. With objectives set and agreed upon in advance, board members are able to contribute relevant and actionable proposal at their very first meeting. Furthermore, none of the companies that started using this method, since 2013, have abandoned it.

I. The Need to Enhance Boards' Role

Corporate boards of directors often fail to reach their full potential business impact. In the context of repeatedly occurring corporate governance failures and scandals, international financial crises and ever-changing, unstable markets, boards of directors are facing higher pressures for transparency and accountability within the corporate governance context. In this context, this chapter discusses the need to enhance the conception of the boards' role and the need for boards to exert more strategic impact on their companies. It also explores board failures and its underlying factors. The prevailing overall view of board's failures in recent times has stimulated the appearance of a higher degree of scrutiny and more pressure from regulators; while at the same time there is a strong call for action in literature, as we will see in the last section of this chapter.

Need for Boards to Exert More Strategic Impact on Their Companies

Boards of directors govern most organizations. In fact, in many countries, having a board of directors of one sort or another is a requisite for incorporation. Given the countless boards in existence today and their substantial importance for continued business success as well as organizational excellence in corporations, it is highly relevant to ask questions and discuss issues such as why do they exist, what they do, and how they can be improved (Hermalin & Weisbach, 2003).

Boards of directors are a valuable component of corporate governance, whose role varies from defending shareholders' interests, through monitoring management to designing the company's strategy (Zahra & Pearce, 1989) Besides selecting, evaluating and overseeing executives within a given firm, boards of directors are supposed to have an active role in the decision-making process of companies (Eisenberg, 1997). This entails the notion of an active board involved in the operations and strategic decision-making activities of senior executives. This should not to be confused with a managing function of the board but should be seen as a dedicated monitoring function.

However, scandals have once again brought corporate governance and board of directors as their top exponent to the forefront of public attention. In response, governments and other institutions have regulated, advised, or recommended better practices for corporate governance (Aguilera & Cuervo-Cazurra, 2004). Kiel and Nicholson (2005) point out governance failures and scandals of big business in the 21st century demonstrate that boards need to review their own performance. There are many who believe that board evaluations can help prevent governance failures. Furthermore, society's demand for increasing accountability and involvement of boards of directors has substantially grown.

Given the increasingly prevalent instances of corporate governance failure, boards are facing higher degrees of scrutiny and significant pressure to ensure effective corporate governance, particularly in the face of the many challenges posed by emerging markets, globalization and the prevalent role of financial markets, digital disruption, environmental and social demands and stronger calls for accountability and transparency. Among shareholders, legislators and society at large, there is an increasing demand on boards to demonstrate leadership, quality decision-making processes and corporate control.

ABA's (Advisory Board Architects, the author's board advisory firm) international survey also confirms the priority assigned to boards' strategic contribution. As already mentioned before, the survey sample included 397 companies from all over the world. They were asked, among other topics, about the strategic value the board was creating for the organization. More than one third of the respondents assigned a very high score to the role of the board of directors in terms of creating strategic value for the organization (a score of 8 or higher on a 10-point-scale, with 10 being highest). This empirical finding echoes the general notion of the strategic role boards should be playing.

Besides the need for appropriate board control and independence (Baysinger & Hoskisson, 1990; Jensen & Zajac, 2004), the boards' strategic role in value creation has been frequently highlighted (Zahra & Pearce, 1989; Golden & Zajac, 2001; Daily, Dalton & Cannella, 2003). Indeed, boards are often in charge of overseeing strategy implementation and monitoring the degree of achievement of corporate goals (Kiel & Nicholson, 2005; Chioatto, 2015). There has been in fact a paradigm shift in the board

role −from management support to organizational leadership.

This kind of leadership calls for heavier strategic involvement of boards of directors. Their strategic role has been widely discussed in theoretically diverse and contextually different studies, with often inconclusive empiric data and sometimes contradicting results (Pugliese, 2009)

In the context of corporate failures in the 1970s and 1980s, boards of directors were criticized for passivity and a lack of involvement at the strategic macro level. The rubber stamp type of board was then seriously questioned. For many the way to restore public confidence in boards of directors was for them to be involved and contribute to companies' strategies and thus become justifiable entities (Clendenin, 1972; Heller & Milton, 1972; Mace, 1976; Machin & Wilson, 1979; Vance, 1979; Zahra & Pearce, 1989).

More and more experts on the field insist on the fact that strategic involvement was an area controlled by CEOs of corporations and nobody else (Ruigrok, Peck & Keller, 2006; Monks & Minow, 2008). Perhaps that is the reason why boards have increasingly engaged in strategic decision-making activities as well as a more challenging roles vis-à-vis CEOs and senior executives (Judge & Zeithaml, 1992; Hoskisson, Hitt, Johnson and Grossman, 2002). By and large, this strategic involvement stems from an increased participation and higher impact of institutional investors (Judge and Zeithaml, 1992; Hoskisson, Hitt, Johnson and Grossman, 2002) as well as reforms in corporate governance at a general level (Aguilera & Cuervo-Cazurra 2004; Enrione, Mazza & Zerboni, 2006; Sheridan, Jones & Marston, 2006).

Moreover, the debate around strategic involvement has been fueled by theoretical perspectives and empirical results that partially contradict one another and open up the discussion for alternatives that need to be taken more and more seriously. More specifically, theoretical viewpoints −such as stewardship theory, agency theory, and resource dependency theory, which will later be reviewed − have proposed different views and sometimes contradictory suggestions regarding the strategic involvement of boards of directors (Davis, 1991; Maassen & Van Den Bosch, 1999).

In summary, the academic community has widely and repeatedly emphasized the

inconsistencies and sometimes fierce theoretical and scholarly debates with regard to the link and interplay between strategy and boards of directors (Johnson, Daily & Ellstrand, 1996; Deutsch, 2005). At the micro level of board members, however, research has quite unanimously contended that board members show an increasing awareness of their strategic role and its importance for the corporation as a whole (Demb & Neubauer, 1992; Heracleous, 2001; Huse, 2005).

According to some schools of thought the strategic role of boards encompasses the review and assessment of executives' analyses and change recommendations. More precisely, boards should not develop new strategies but they may recommend changes in company strategy. The board thus contributes to strategy development through careful enhancements of proposed strategic plans, by asking probing questions regarding management's assumptions about the firm and its environment, and by confirming that management is in agreement about the course to be taken (Andrews, 1980, 1981a, b; Zahra, 1990).

Yet, another school advocates that boards go beyond their service and control function to take active part in strategy. It proposes a close collaboration between the CEO and the board in plotting strategic directions for the firm (Pettigrew, 1992). In this case, directors may propose ideas for new strategies and carry out analyses that lead to re-examination of existing strategies. Hence, directors should not limit themselves to approving managerial choices (Zahra, 1990).

Board failures

> *"Frankly, we used to be pretty lazy about boards. They were largely seen as being rewards for past service. There was an assumption that talented CEOs could move easily from their executive posts into a board setting. The boards were large and often perfunctory in the performance of their duties. I have been on the board of a large financial institution in a developing economy that had more than 50 directors, and the main event was always the lunch that followed the three-hour board meeting".*

These are the words of David Beatty, Canadian businessman and academic who serves as a Director of three Canadian leading corporations. He is currently the Conway

Director, at the Rotman School of Management at the University of Toronto. He has served on more than 35 Boards of directors and been Chair of 8 publicly traded companies. He is also a McKinsey & Co Senior Global Adviser on Corporate Governance and Joint Venture Governance. As such, Beatty has trained McKinsey partners at Harvard and Oxford.

The above quote is from an interview by Jonathan Bailey and Tim Koller from McKinsey's New York office, entitled Are you getting all you can from your board of directors? (November, 2014).

This view is certainly not uncommon and the critics of board behaviors and functioning are many. This section reviews the most common failures described by academics and practitioners alike, which include the following:

- Lack of expertise and knowledge of industry.
- Lack of oversight.
- Excessive emphasis on short term financial results.
- Lack of emphasis on long term value creation.
- Lack of understanding of fiduciary duties.
- Conflicts with CEO and top management.
- Lack of the relevant information.

Lack of expertise and knowledge of industry. This is certainly one of the most cited shortcomings of boards of directors, often referred to by board chairs themselves, as we will see later in this work.

Olubunmi Faleye, Rani Hostani and Udi Hoitash −authors of the paper Industry Expertise on Corporate Boards, *SSRN* (*Social Science Research Network*, January 2017) − study the importance of industry expertise and its impact on corporate results. Industry expertise offers boards the advantage of counting on individuals who deeply understand the risks and opportunities within the company's sector, know the regulatory environment and the key industry players. The authors point out that despite the lip service given to this trait, there is almost no work published that attempts to assess its impact on company performance. Their goal in the research work undertaken was "*to fill this gap by examining whether, how, and in what circumstances directors' industry expertise enhances board effectiveness*".

To measure this kind of impact, the authors studied the professional histories of independent directors in a sample of 1,528 companies. Their conclusions are most illustrative:

> *"We find that firm value is significantly higher when industry experts serve on the board. In particular, the presence of an industry expert independent director is associated with an increase of 4.6% in firm value. We also find a robust positive and statistically significant association between board industry expertise and corporate innovation measures such as R&D investments, patents granted by the U.S. Patent & Trademark Office (USPTO), and patent citations. Yet, our results show that board industry expertise has no effect on acquisition outcomes. These results suggest that industry expertise enhances board effectiveness by facilitating organic investments in corporate innovation rather than through improved acquisition performance".*

Of particular interest is the fact that, according to the authors, industry expertise of boards is particularly relevant for company innovation:

> *Our findings suggest that board industry expertise is associated with monitoring decisions that are consistent with motivating innovation. Specifically, we find that board industry expertise significantly lessens the sensitivity of CEO dismissal to firm performance, both in terms of operating profitability and stock market returns. We also find that board industry expertise is associated with a significant increase in stock option awards and a significant reduction in cash-based pay.*
>
> *Overall, this paper demonstrates the significance of industry-specific skills in board effectiveness, especially in value creation and when corporate innovation is a significant value driver".*

Dr. Richard Leblanc is an Associate Professor of Law, Governance & Ethics at the University of York, author of books, papers, articles and blog posts on the general subject of corporate governance and, in particular, on boards of directors. In a post published in January 2014, (Why Corporate Boards Lack Courage) in the *Governance blog of York University*, he contends that the lack of industry experience is behind the performance failure of many a board:

> "*Be it technology, transportation, mining or financial services, if you scrutinized failed or underperforming boards –really scrutinize− this serious shortcoming− the lack of industry experience and leadership – will become obvious. Many more directors need to have been the primary person responsible for driving*

superior performance and redefining competitive dynamics within the industry for corporate boards to be effective".

He also adds that:

> *"These directors should be sourced globally. Local accountants, lawyers, business school deans, consultants, politicians and even CEOs of unrelated industries are nice but they should be a minority. A majority of these latter individuals is not the recipe for an effective board. Sadly, many corporate boards look like this, are dated, and are in dire need of renewal and diversification".*

Lack of oversight. More than ever, corporate risk taking and the monitoring of it are at the stage center for boards of directors, regulators and the media. The complexity of business transactions, globalization, technology advances and rapid changes in many fronts have made risk management and oversight more and more difficult and complex. Risks are not only financial, as Commissioner Luis A. Aguilar from the Securities and Exchange Commission (SEC), pointed out in his speech −The Important Work of Boards of Directors at the *12th Annual Boardroom Summit and Peer Exchange* New York, NY, Oct. 14, 2015− besides natural disasters, "*Crisis events can also be man-made, such as accounting scandals and other serious regulatory violations, product defects or even terrorist attacks… Examples of foreseeable man-made crisis might include… oil spills, automobile recalls and outbreaks of foodborne illnesses. To this list of course you can add cyber-attacks. Ultimately each company and industry faces its own unique risks that are foreseeable, and therefore worthy of any prudent board's attention*".

Boards are increasingly conscious of the importance of their risk oversight function, which goes far beyond compliance with regulatory requirements. Shareholders have become more and more demanding too, regarding the board's responsibility for risk oversight and are taking steps to hold directors accountable for failures in this respect.

A very recent example is that of Wells Fargo & Co. For years (2011-2016), Wells Fargo employees had been opening unauthorized accounts in order to meet the aggressive sales targets set by the bank's management. The number of unauthorized accounts is

believed to have reached 2 million. Senior executives in the consumer business have been fired, and John Stumpf, Chairman of the Board and CEO, was forced to resign. In April 2017, ISS (Institutional Shareholders Service), a prestigious proxy service firm, has recommended Wells Fargo's shareholders to replace 12 of the 15 directors of the Board. The ISS report specifically states that: "*The board failed to implement an effective risk-management oversight process in a timely way and that could have mitigated the harm to its customers, its employees and the bank's brand and reputation*," it also points out that: "*The long-standing sales practices and unchecked incentive program evidences a sustained breakdown of risk oversight on the part of the board*."

As Commissioner Aguilar states: *Ultimately, while there is no "one size fits all" approach to board oversight of risk management, the goal is to give proper attention to a company's perceived risks to ensure sufficient preparedness. This can mean making sure the board is appropriately informed about the global risks facing an organization or its broader industry, tasking appropriate personnel with monitoring and preparing for such risks, and implementing protocols to be able to quickly respond if and when such risks become a crisis event".*

In the final remarks of his speech, the Commissioner highlights the importance of board assessments to constantly improve their effectiveness in all the obligations they perform: "*… boards have a fiduciary responsibility to ensure that they possess the necessary skills, experience, and judgment to be competent stewards of their companies. Meeting this high standard can be challenging and it requires boards to routinely undertake a rigorous and honest assessment of their own abilities and performance. Such assessments are rarely easy, and are sometimes painful, but they are essential if boards are to meet the implacable demands of today's constantly evolving business environment.*

Many consultants, practitioners and scholars have contributed their diagnoses and their recipes for improving the risk oversight function of boards.

The firm Conselium-Compliance Executive Search, in an article (10 Ways Board Risk Oversight Can Fail) published on *Corporate Compliance Insight* (an online forum devoted to the subject of corporate compliance), included a 10 point diagnose of reasons

for failure in boards' risk oversight (posted by Jim Deloach, in January 2014). Among others, the following failures are included:

- The lack of appropriate processes to identify, manage and monitor the company's critical risks.
- Ignoring or not closely monitoring the assumptions underlying the corporate strategy.
- Board and top management differ on their view about the company's risk appetite.
- Excessive data without enough meaning.
- Deficiencies in "tone at the top culture"

Regarding this last issue, the article states that:

"While the concepts of balancing and preserving values and emphasizing both short-term and long-term objectives are relatively straightforward, effective leadership and strong discipline are required in order to pull them off. The Board must ensure that the appropriate leadership and discipline are in place; otherwise, dysfunctional behavior, with the attendant consequences, can set in. The question for the Board is: Will the CEO and executive management team heed the warning signs at the crucial moment?"

Finally, it concludes by suggesting various topics that the board should discuss with top management, such as defining the board's risk oversight goals, evaluating the effectiveness of the risk oversight processes or taking the necessary steps to eliminate potential obstacles to achieve the said effectiveness.

To ensure that the risk oversight function serves its purpose, a Bloomberg Law Report (The Role of Board of Directors in Risk Oversight in a PostCrisis Economy, by William B. Asher, Jr. and Michael T. Gass, Choate Hall & Stewart LLP, and Erik Skramstad and Michele Edwards, PricewaterhouseCoopers © 2010 Choate Hall & Stewart, LLP and PricewaterhouseCoopers LLP. Originally published by Bloomberg Finance L.P in the Vol. 4, No. 13 edition of the Bloomberg Law Reports—Corporate Law). Recommends the following actions:

1. *"Review the Board's Risk Oversight Structure.*
2. *Task Management to Reassess the Corporate Risk Management System.*
3. *Assure That the Information Flow to the Board Is Regular and Transparent.*
4. *Align Risk Management with Business Strategy*".

Of particular importance are perhaps recommendations number 3 regarding the information the board receives and recommendation 4 about the coherence between business strategy and risk management.

Better-performing boards have found a balanced formula for overseeing and encouraging the management team, while constructively challenging management's decisions as required. This contention comes from Ernst & Young-Canada's report entitled: *The critical role of the board in effective risk oversight*, published in 2013. Based on their research, the consulting firm argues that companies with more evolved risk management practices obtain better financial results than comparable corporations.

The report recommends the use of a risk framework to ensure a more effective risk management. Nevertheless, the authors issue a warning: "*Risk frameworks provide structure and information, but they don't replace the board's well-considered challenges to management's plans and activities".* They also contend that a structured risk focus makes it easier for management and the board to effectively manage risk.

According to E&Y research, top performing corporations usually count on a board sub-committee that takes the lead in defining risk management objectives. A collective understanding has to pervade the whole organization regarding risk appetite and tolerance. Metrics must be established and monitored. Otherwise, issues posing substantial risks may not be evaluated consistently. The authors go on to point out that:

> *"The need to balance risk mitigation with active risk-taking creates an interesting dynamic between board members and management (whose performance objectives may encourage them to take on more risk). Management does its part by considering the likelihood and impact of each risk, prioritizing the risks, analyzing interconnectivities and assessing the impact of multiple risks occurring at the same time. They also assess the organization's risk profile against its risk appetite and capacity for handling potential consequences, and choose to accept, control, share or insure the risks. The results of these activities are presented to the board for approval."*

To assist the board and top management to establish and implement an effective risk management framework, E&Y report suggests a list of questions to be answered explicitly. They are included in the following table:

Key questions

- Do we have the right balance between strategic and compliance risks?
- How do we know that risks that could impact performance are identified, assessed, and managed on an ongoing basis?
- Are we doing our best to expect the unexpected?
- Has our organization forged good working relationships with employees, customers, suppliers, creditors, partners, regulatory bodies, competitors and the local community?
- Are our directors fully cognizant of the benefits, implications and potential risks of social media, and do we have effective risk management policies in place?
- Are we doing enough to validate that our culture reflects our stated values?
- Are we living our values on a daily basis, or paying lip service to them for the sake of public relations?

Excessive emphasis on short term results. This strong emphasis on short-term results has been criticized by many as a cause of sometimes disastrous results. Ultimately the goal of any board of directors is to perform their oversight and strategic support functions to help management's efforts to create long-term value. Unfortunately, many boards are failing in this area. Through their overemphasis on short term results, they incur in what is now known as short-termism at the expense on long term value creation for all parties involved, not just shareholders.

According to an Ernst &Young-Poland report published in 2014 (Short-termism in business: causes, mechanisms and consequences): "*the short-termism phenomenon… deteriorates firms' competitiveness, increases systemic risk, and reduces the long-term potential of the entire economy.* The report is based on research carried out by the firm for the 1,024 largest companies listed on the European stock markets.

The E&Y report points out that short-termism is particularly acute in public traded companies whose top management and boards are under pressure from their shareholders to deliver short-term results. The drivers of this trend, which have been

going on for several decades, include such factors as new technologies, which allow shorter trading times and lower transaction costs; consequently, market volatility increases. Media coverage and more demanding institutional investors also play a significant role in this short-termism phenomenon. Short-term focus is also reinforced by "*companies' market communication and financial reporting practices, which largely focus on the short-term performance and, from the shareholders' point of view, serve as an instrument for monitoring their short-term goals. Consequently, short-termism often results in "earnings management" rather than building the long-term value of the company"*. Other authors and experts often mention as a driver of this trend the executive and director compensation schemes that incentivize short-term performance.

According to E&Y, short-termism has three major consequences:

- *Shortened CEO tenure,*
- *the neglect of investment activity and*
- *the neglect of human capital.*

"Short CEO tenure and neglect of investment outlays decrease a company's long-term value and profitability, as well as the ability to adapt to new market conditions and compete on a global scale. In this way, if short-termism affects many firms, it translates into the reduced potential of the entire economy".

Imre Lövey −a managing partner and founder of Concordia, Inc., one of Hungary's first and most prominent management consulting and training firms, together with his co-authors Manohar Nadkarn and Eszter Erdélyi− in his book How Healthy Is Your Organization?: The Leader's Guide to Curing Corporate Diseases and Promoting Joyful Cultures (2007) writes about "*the Money Mania*" in companies. Companies suffering from this disease focus almost exclusively on the financial aspects of managing a corporation. Their aim is minimizing costs and maximizing short-term profits. "*Money is perceived almost as the only value, which matters to such an extent that it overpowers other values, for example, value addition for customers and value creation by employees"*.

Companies suffering from this Money Mania are continuously implementing cost reduction programs. They delay as much possible the necessary investments. Employees and departments are evaluated on the basis of their capacity to generate revenue, and profit centers receive more attention and resources than cost centers. Suppliers are squeezed to the maximum and often abandoned in favor of others offering reduced prices. The boards of this type of company obviously suffer from the same condition and do not strive to achieve the correct balance between short-term profits and the long-term success or even survival of the corporation.

Matt Orsagh – an expert on corporate governance at the CFA Institute, named one of the 2008 "Rising Stars of Corporate Governance" by the Millstein Center for Corporate Governance and Performance at the Yale School of Management− in his article How Boards Can Adjust to an Era of Increased Investor Power (Bloomberg Law, September 2014) refers to the checklist developed by the CFA Institute to help boards become "the *long-term stewards that investors expect*". From that checklist, three aspects are worth stressing:

- *"**Quarterly Earnings Practices**. A Visionary Board expects management to deliver investor guidance with a longer-term bias and in greater detail by identifying long-term value drivers for the company. This approach helps to incentivize share "ownership" among the investors the board represents".*
- *"**Shareowner Communications**. A Visionary Board proactively listens to the concerns of its shareowners and consistently communicates its long-term vision and strategy".*
- *"**Executive/Director Compensation**. A Visionary Board understands a company's compensation policies and ensures that the underlying objectives consistently support the long-term strategy and performance of the company as well as the appropriate company risk profile".*

Lack of emphasis on long term value creation. According to Dominic Barton, Global Managing Director of McKinsey & Co., (Capitalism for the Long Term, *Harvard Business Review*, March, 2011), businesses have "*to fight the tyranny of short-termism*", this is his first recommendation. In his view, the greatest difference between Eastern and Western corporate cultures is the time frame they apply to their strategic thinking. Asian companies usually have a perspective of 10 to 15 years, whereas

American and European corporations, institutions and even politicians suffer from "*myopia*". Barton believes that the long-term perspective of Asian companies achieves them great competitive advantage. He also highlights the fact that, since 1995, the average tenure of CEOs has gone from 10 to 5 years and refers as well to the "*mania of quarterly earnings*" that "*consumes extraordinary amounts of senior time and attention.*" Interestingly the author quotes some exceptions to the short-termism ailment of capitalism:

> "*Some rightly resist playing this game. Unilever, Coca-Cola, and Ford, to name just a few, have stopped issuing earnings guidance altogether. Google never did. IBM has created five-year road maps to encourage investors to focus more on whether it will reach its long-term earnings targets than on whether it exceeds or misses this quarter's target by a few pennies. "I can easily make my numbers by cutting SG&A or R&D, but then we wouldn't get the innovations we need," IBM's CEO, Sam Palmisano, told us recently. Mark Wiseman, executive vice president at the Canada Pension Plan Investment Board, advocates investing "for the next quarter century," not the next quarter. And Warren Buffett has quipped that his ideal holding period is "forever." Still, these remain admirable exceptions*" .

The second recommendation from Barton is: "*Serve Stakeholders, Enrich Shareholders*". He contends that although these two aims are often considered an either-or issue, in fact they are not mutually exclusive and can be pursued simultaneously. Taking into consideration the interests of all stakeholders is essential for long term corporate value creation. One could add that it should be top in the agenda of boards of directors. Barton also points out that it is the only way to restore the public trust in businesses, which is only at 45% in the UK and the USA, compared to 61% in China, 70% in India, and 81% in Brazil.

Barton's third recommendation directly concerns the behavior of boards of directors: "*Act like you own the place*". He contends that when ownership is broadly distributed, no one behaves like being charge. Boards are far from doing that and Barton cites the example of Merrill Lynch board of directors who were unaware of the degree of risk assumed by the firm until it was too late to act. Barton offers us too, a quote from Larry Fink −CEO of the investment firm BlackRock, during a 2009 debate about the future of

capitalism sponsored by The Financial Times. In Fink's opinion, risk management did not fail, but "··· corporate governance failed, because…the boards didn't ask the right questions."

Barton then goes on to explain the concept of ownership-based governance, based on three pillars:

- More-effective boards.
- More-sensible CEO pay.
- Redefined shareholder "democracy."

***More effective boards**. The board must represent a firm's owners and serve as the agent of long-term value creation. To this end, boards must spend much more time than they currently do on their tasks. In particular, more informal time has to be spent with corporate executives and investors as well. Barton refers to the example of companies owned by private equity firms: "The nonexecutive board directors of companies owned by private equity firms spend 54 days a year, on average, attending to the company's business, and 70% of that time consists of informal meetings and conversations. Four to five days a month obviously give a board member much greater understanding and impact than the three days a quarter (of which two may be spent in transit) devoted by the typical board member of a public company".*

Boards need as well more relevant experience and industry knowledge, as well as committee structures that prove more effective. A novelty proposed by Barton is the addition of resources assigned to directors "*to allow them to form independent views on strategy, risk, and performance (perhaps by having a small analytical staff that reports only to them)*".

More-sensible CEO pay. Boards do not determine executive pay with a long-term perspective. Incentive schemes, such as the once revered stock options, have often incentivized wrong behaviors. Furthermore, compensation plans do not carry any punishment in case of failure or wrong doing and as Barton phrases it "*many of the leaders of failed institutions retired as wealthy people".* He also adds that: "*Companies should create real risk for executives. Some experts privately suggest mandating that new executives invest a year's salary in the company".*

CEO pay should be defined taking into consideration long-term value creation, linking compensation with such indicators as efficiency and innovation. The board should take very seriously the evaluation of top executives, "*for example, using rolling three-year performance evaluations, or requiring five-year plans and tracking performance relative to plan".*

Redefined shareholder "democracy". This concept entails, according to Barton, giving some kind of incentive to long-term shareholders. He specifically states that: "*Maybe it's time for new rules that would give greater weight to long-term owners, like the rule in some French companies that gives two votes to shares held longer than a year. Or maybe it would make sense to assign voting rights based on the average turnover of an investor's portfolio".*

To conclude this subsection, we include below a table developed by the National Association of Corporate Directors (NACD Blue Ribbon Commission), in its 2015 Report entitled: *The Board and Long-Term Value Creation*.

Risk Appetite Frameworks: Considerations for Directors

- A reference list of more than 20 questions can help directors to evaluate the following:
- Tradeoffs between the organization´s willingness to take risks and its ability to do so
- The level of agreement among individuals in the executive team – and between executives and the board – on issues such as the types of acceptable risk versus those to avoid.
- The data and metrics the organization uses to assess risk and risk appetite.
- How the risk culture is reflected in decision-making at different levels of the organization

Long-Term Oriented Performance Metrics

Examples of long-term metrics in nine different categories:

- Business development
- Company culture
- Corporate governance
- Environment, health and safety (EHS)
- Financial Performance
- Innovation/research & development (R&D)
- Operations
- Reputation
- Talent

Capital Allocation: The Role of the Board

Guidance to support directors' discussions with management in four key areas:

- Alignment capital allocation with strategy
- Assessing management's capital allocation process
- Evaluating tradeoffs on the use of cash –i.e., investment versus returns to shareholders
- Clarifying the role of the board

Executive Compensation and Long-Term Value Creation

Sixteen questions that will enable boards to:

- Get "behind the numbers" of management's annual budget
- Fine-tune the mix of short-term and long-term incentives
- Evaluate whether goals and targets are appropriate in terms of accountability and "stretch" opportunity
- Build long-term milestones into annual incentive plans
- Take such issues as business cycles and individual career paths into account when designing a compensation program

Source: NACD Blue Ribbon Commission. The Board and Long-Term Value Creation (2015)

Lack of understanding of fiduciary duties. Traditionally, the two main fiduciary duties have been two: the duty of care and the duty of loyalty; the duty of disclosure is nowadays also included as a third obligation of board members, whether executive or independent directors, they are all subject to the same obligations. Still others consider the duty of disclosure as derived from the other two basic duties (care and loyalty).

The duty of care demands of all board members to act in good faith and consider the best interest of the company in the decisions they take. To this end, they must always investigate all available options to ensure they choose the one that is best for the company.

The duty of loyalty implies that directors have to put the corporation's interest before their own. This is what is often called "the business judgment rule". The board has to exercise its best judgment when they decide to take any action. But even when taking the most pondered decision, boards may fail and decisions taken may prove to be the wrong ones, since many business decisions are inherently risky. Perhaps, that is the reason why not many directors have been taken to a justice court. Judges recognize this

risk and therefore will not punish directors who made a well informed and honest decision, even if it brings about the most undesirable results.

"*In many companies affected by scandal, directors do not understand or pay close attention to their core duties: care, loyalty, good faith, compliance, and oversight. Directors must use the tools at their disposal to effectively execute their responsibilities*". This critic statement was made by John H. Stout, in an article published by The International Finance Corporation in 2012: Integrity, Culture, and Other Intangibles for Building Long-Term Value—The Board's Critical Responsibility (Issue number 30 of *Private Sector Opinion*, *A Global Corporate Governance Forum Publication).* Stout, who is Chair, Corporate Governance & Investigations Group at Fredrikson & Byron, contends that integrity is the board's primary responsibility. "*In many corporate scandals, boards failed because they did not take responsibility for their organization's integrity. The directors did not see the organization's integrity as an extension of their own integrity. Ultimately, that is the critical point*".

Shareholders and stake holders expect from boards, according to Stout, to promote a culture of integrity that permeates the whole corporation, its top management, middle management and employees. The board is responsible for hiring directors and top executives of high integrity and skills and for "*ensuring that the organization has and practices values that support a culture of integrity, fairness, trust, and high performance".* Integrity contributes greatly to increase the company's goodwill. Goodwill represents the difference between the fair market value of the company based on its tangible individual assets and the overall value of the company as a whole, which includes intangible assets such as goodwill.

As Stout points out: *For most companies—particularly such high-profile companies as Starbucks, Apple, Microsoft, Petrobras, Berkshire Hathaway, Infosys, and Tata—the goodwill on their balance sheets may, and often does, outweigh the monetary value of their tangible assets. It's critical that the board and all employees—especially management, advisors, and consultants (particularly, its lawyers and accountants)—act to protect and enhance the organization's integrity and goodwill".*

Boards need to embrace transparency, to appoint independent directors and to take very seriously its fiduciary responsibility. Regarding the latter, Stout states that: "*In many corporate scandals, directors demonstrated their lack of understanding of what it*

means to be and act like a "fiduciary." Whether serving public, private, family owned or government-controlled companies in Asia, Africa, South America, Europe, or North America, directors need to behave as fiduciaries or stewards of others' money and assets".

A corporate culture of integrity is essential to avoid the scandals, malpractices and frauds that we have witnessed during the last 15 years. As noted in Stout's article: "*Corporate culture has been a serious problem in many high-profile corporate failures. Examples of greed, inappropriate executive compensation and perks, placing profit and personal gain (through self-dealing and insider trading, for example) above legal compliance and ethics, and excessive risk-taking are numerous".*

Developing and maintaining such a culture requires close work and cooperation between the board and the company's top executives. Furthermore, and most interestingly, Stout recommends "*periodic independent assessments of the company's ethics, values, compliance, and training programs"*

About the subject of compensation, "*one of the most provocative issues illustrating integrity and values",* Stout believes that excessive director and top executive compensation, "*particularly when the company's performance has declined, reflects poorly on directors' independence, integrity, and judgment".* Boards must oversee the company's compensation policy to ensure that it is *"fair, transparent, and responsive in rewarding excellent performance, addressing poor performance and that is designed to attract and retain the best talent without detracting from the corporation's integrity or corroding the company's culture".*

Conflicts with CEO and top management. There are two negative situations that typically occur in the board-executive managers' relationship. One is open conflict and the other one is board weakness before the company's CEO and other top executives. The board does not question their decisions and simply plays an acquiescing role.

Both situations have negative consequences for the corporation and constitute flagrant failures of the board. In the conflict situation, the problem arises because there is no

clear frontier between where the board's oversight role ends and executive management begins.

Ann Skeet (When Boards and Management Conflict. How to Improve Corporate Governance's Most Important Relationship, May 2015, Markula Center for Applied Ethics, Santa Clara University, Silicon Valley) diagnose of the tension arising between boards and CEOs cites as a principal cause: "*poor relational competence*". She also records some arguments given by the two sides, in the interviews held with directors and CEOS of several Silicon Valley firms: *Those speaking from the director's perspective cite arrogance of the CEO as a root cause of runaway management teams in the stories they relate. Perhaps not surprisingly, those who are CEOs cite board members who function "out of position" or hold conflicts of interest that prevent the effective governance even when disclosed as contributing factors to the board's perception that a management team is out of control. Where you stand, as is often the case, depends on which chair you are sitting in.*

Skeet notes that what directors call arrogance is actually either lack of experience, different views about the company's strategy or even deceitful CEOs. The latter may withhold information from the board, present revenue that has not truly materialized or incur in other unethical or even fraudulent practices. She goes on to add *that Board members can always ask themselves what information is not at hand and request additional information if their instincts suggest that the CEO is concealing something. The board has the legal right to request information, and management cannot suppress it once it is requested".*

The point of view of CEOs is also explained in the article, their arguments, according to Skeet, fall in one of two categories:

1. *directors who are "out of position," most likely playing the role they have or have had as CEO at another company*
2. *fundamental conflicts of interest, which even if disclosed, prevent the board member from truly placing the interests of the organization above his own personal interests, or the interests of a group he represents, such as investors.*

Jeffrey Sonnenfeld, Melanie Kusin and Elise Walton (What CEOs Really think of Their Boards, *Harvard Business Review*, April 2013 Issue) note that the CEO's perspective on

their boards has received much less attention. On the one hand, they are not very willing to talk and express their opinions for fear of exposing themselves, and on the other, experts on corporate governance have not devoted much effort to obtain the CEOs' point of view.

To fill this gap, the authors tapped their networks *to bring CEOs' opinions to light.* They record as board's flaws:

- Risk aversion and conservatism.
- Insufficient knowledge of the business.
- Not enough ex-CEOs on boards, although the authors point-out that they have also heard *about retired CEOs who became overinvolved with management and generally acted as if they hoped to regain a lost sense of power and glory.*
- "Professional directors" retired from their business careers. CEOs' concern in this case is that the top interest of this kind of director is to preserve his or her seat at the board.
- Excess of conflict aversion. "*As one CEO describes the phenomenon, "In the boardroom, the thinking is: You have to be equal. Don't be overwhelming or dominant, don't hurt feelings, and don't take someone's chair. It's all about getting along."* The authors remark too that the reverse is also true and that "*needless aggressive discussions*" happen more often than one would think. The right balance should be sought between agreement and dissent. "*Instead of aggressively advocating a point of view, directors should ask probing questions, CEOs say".*
- More careful and smooth succession plans to avoid difficult and embarrassing situations such as the ones quoted by the article: *In recent years a number of successful, visionary leaders, including the Gap's Mickey Drexler, JetBlue's David Neeleman, and Motorola's Chris Galvin, have been fired by their boards—and in each case the CEO was blindsided, with no chance to address the loss of faith by a board that didn't even allow a group discussion. Thus, can a board inflict more-profound damage on a corporation than its most ferocious competitor or regulator?*

Lack of the relevant information. The relevant information must be available to boards, if they are to be able to make the right decisions. The most common danger is for boards to receive too much information with not many insights.

"*In the past, a typical board's approach to understanding the company's strategy often consisted of listening to one manager after another give formal, highly rehearsed, and lengthy presentations. One director we know calls presentations like these "death by slide."* This statement comes from an article by Richard D. Parsons and Marc A. Feigen (The Boardroom's Quiet Revolution, *Harvard Business Review*, March 2014 Issue).

The authors highlight the positive changes that have been taking place in boards during the past ten years with the result of turning them more efficient. In their view, one of the more positive developments is that "*the quality of the conversation*" in boards has significantly improved. This is brought about by directors spending more time with management preparing board meetings, boards visiting different company sites to better understand the business and holding off-site meetings for a couple of days.

Closer contact and fluid communication are essential, but the quality of the information received by the board to prepare meetings is as crucial. What are usually called "board packs" contain the information needed by the board to make fully informed decisions. The task of preparing the relevant information is performed by management and the tendency is usually to provide too much data in formats that are not so meaningful.

According to Effective Governance −a leading independent corporate governance consulting firm operating in Australasia− (article published in its website: "Six questions about board packs" in June 2014) common mistakes found in board packs include:

- Too much data.
- Excessive emphasis on financial and operational information.
- Lack of sufficient information on potential risks, challenges and opportunities for the company. In this respect, the article adds that "*boards are also guilty of wanting too much financial and operational information, which is a failure of the board to distinguish between governance and management".*
- Sending the information to the board too late, therefore not allowing directors enough time to prepare. They should even have enough time available to ask the CEO and managers the questions they deem necessary prior to the board meeting, whether on the phone or by electronic means. *The provision of timely and accurate information can be critical to the board's ability to appropriately challenge and scrutinize management",* Effective Governance remarks.

- Excessive reliance on management for the information needed by the board. In this sense, Effective Governance suggests that perhaps "*an independent source can be brought in to share the responsibility with management e.g. an external expert may assist management in preparing an important report for the board"*.

Finally, they warn about the perils of management providing independent directors misleading or incomplete information. The potential pitfalls they note include the following: Management

- *"Fails to disclose information because of its impact on staff or themselves.*
- *Uses information to control or manipulate the board, e.g. providing selective or excessive/irrelevant information in the board pack.*
- *Knowingly uses the non-executive directors' fear of appearing ignorant to avoid questioning by use of complicated or jargon-based information".*

The article also provides some useful guidelines for preparing the board package. For instance, it warns about the need to prioritize issues and concentrate on "*key matters of substance*", rather than providing operational details. When management is seeking approval from the board for a given initiative or decision, the document presented should include clear information and advice about what is being recommended.

The amount of information should be limited "*to ease the burden on busy directors"*. The papers should be written in plain, clear language, for readers that may know less about the subject at hand. Jargon and abbreviations should be avoided or at least explained.

Finally, the consulting firm suggests the use of the following guidelines:

- *"Dot point format is preferable to lengthy paragraphs.*
- *Lengthy documents should contain an executive summary, table of contents and section and page numbering system, for easy reference.*
- *Key points, options and recommendations should be highlighted, bolded or underlined.*
- *Any complex technical terms should be explained, preferably in a glossary.*
- *Be well written – the paper should be checked for spelling errors, bad grammar, rambling sentences, etc.*

- *Tell the unvarnished truth not just the "good news" – board papers can sometimes focus on the positives and gloss over the negatives.*

And *Uniformity and consistency can be achieved by using a board paper template".*

Higher Scrutiny and More Pressure from Regulation

All in all, over the past decades the increasing challenges from a fluctuating economic environment, pressures of globalization and increased regulatory requirements for companies resulted on higher scrutiny of boards' performance. The need to assess boards' performance in terms of their effectiveness and efficiency at fulfilling initially set objectives and goals became widely recognized. This has fuelled a global trend to establish principles-based jurisdictions for boards' effectiveness assessment and board evaluation recommendations (Deloitte, 2014).

Geoffrey C. Kiel and Gavin J. Nicholson (2005) present some examples of this global trend: "*The Principles of Good Corporate Governance and Best Practice Recommendations (ASX Corporate Governance Council, 2003) in Australia, Beyond Compliance: Building a Governance Culture (Saucier, 2001) in Canada, the Combined Code on Corporate Governance (Financial Reporting Council, 2003) in the UK, and the Principles of Corporate Governance (A White Paper from the Business Round-table, May 2002) (Business Roundtable, 2002) in the US, all make specific recommendations for the regular review of board performance*. "

The following three pages are from Jaime Grego-Mayor's previous research work: Boards of Directors in Small and Medium Sized Enterprises: Are they useful. Research Project for his Master's Degree in Social Sciences. Research Tutor: Professor Miquel Bastons):

> "The first country to issue a code of good governance was the United States in 1978. The second was Hong Kong in 1989, eleven years later. Since then, the pace of issuance has increased, particularly after 1992 when the United Kingdom's Cadbury Report was issued. The spread of codes of good governance globally was helped by the impetus from transnational institutions, such as the

World Bank and the Organization for Economic Cooperation and Development (OECD), which started emphasizing the need to improve institutions in general and corporate governance in particular in order to help countries grow and develop.

By the late 80's, 64 countries had issued 196 separate codes of good governance. Moreover, there is a large diversity of issuers of codes. These are not only stock markets or their regulators, but also associations of employers, professionals and even governments.

The explosion in the number of codes of good governance was followed by an upsurge in the number of articles in academic publications. For example, since 1997, Corporate Governance: An International Review has published 14 papers that explicitly discuss the nature of codes in a given country and 59 papers that contain the phrase "governance code" in their abstract.

There is, however, little methodical analysis of how codes of good governance have affected company structures or how managers behave across different corporate governance systems. Furthermore, there is some contradictory data on the success of codes of good governance.

The codes do have some key universal principles that they share and are common to most countries. These are explicitly or implicitly:

- A balance of executive and non-executive directors, such as independent non-executive directors.
- A clear division of responsibilities between the chairman and the chief executive officer.
- The need for timely and quality information provided to the board.
- Formal and transparent procedures for the appointment of new directors.
- Balanced and understandable financial reporting.
- Maintenance of a sound system of internal control (Aguilera & Cuervo-Cazurra, 2009).

As mentioned above, codes have also been created by transnational entities to address the necessity for better corporate governance in multiple countries, not just those of a single country, as is generally the case with national codes of good governance. These transnational codes of good governance are significant

for two reasons. First, they signal the importance of corporate governance and help institute best practices directed to common corporate governance issues of companies worldwide. Second, they serve, in some cases, as the basis for the creation of codes in individual countries (Aguilera & Cuervo-Cazurra, 2009).

This has led to the idea that corporate governance may be "converging" worldwide. This concept has met with some criticism. It would appear that the writing on convergence often assumes that governance systems are divided into two distinct types – the "market based" US system and the "relationship-oriented" or "stakeholder-based" models found in such countries as Germany and Japan. The emergence of a number of nations with their own idiosyncratic governance systems as key players in the global scene makes this division an oversimplification (Yoshikawa & Rasheed, 2009).

Between the public firm controlled by professional managers and owned by dispersed shareholders and the privately held firm, where a founding family or group of investors own all the shares, there is a widespread but little researched category of firms: those publicly listed but substantially owned and controlled by a founding family or investor group (Yoshikawa & Rasheed, 2009).

Finally, any system of governance reflects the distribution of power within a society. In the U.S., the state has historically tried to influence corporate governance. Despite these efforts, the role of the state in the U.S. is much smaller than in countries such as Russia or China. From a different angle, the power that labor unions enjoy in Germany is higher than in most other developed economies, reflecting the influence of this stakeholder group.

Therefore, it would seem that real convergence is unlikely to be an immediate phenomenon, since different societies are at different equilibrium points in the distribution of power. It will be interesting to continue to observe this phenomenon. Perhaps it will lead to a degree of hybridization as global codes mix with highly specific national contexts (Yoshikawa & Rasheed, 2009).

Finally, however, one basic principle behind codes of good governance will always have to be taken into account: investment flows to where shareholders are more protected (Aguilera & Cuervo-Cazurra, 2009)".

Call for Action in Literature

In the last decades, there has been a general call for action to implement more systematic and regular board evaluation practices. One of the many reasons for the increased attention and academic activity around the topic is the earlier mentioned paradigm shift that brought boards from passive and ineffective to influential and strategic bodies. From this perspective, boards are contributing to forge sustainable competitive advantage for their organizations and enjoy the status of a corporate asset with high potential for value creation and organizational improvements. This is why they should be studied, theorized and methodologically discussed in detail (Minichilli, 2017; Huse, 2005).

Secondly, evaluations are perceived as contributing to the directors' capacity to create value. In fact, they can help boards to avoid crises in the organizations they govern and to recognize and correct performance gaps (Kiel & Nicholson, 2005). Institutional investors, stakeholders and regulators exert pressure on Boards to demonstrate accountability and leadership in the organization (Minichilli, 2017) As a result, there has been a proliferation of recommendations and codes of best practices in the corporate context, rendering necessary an in-depth, rigorous and well-researched discussion and proposition of corporate governance evaluation practices.

Shortcomings still exist despite the fact that a formal system of evaluation is a mandatory requirement in many codes of good governance.

The relevance and urge of studying board evaluations derives too from the fact that boards have more and more influence on strategic objective setting for companies, on compensation plans for C-level executives, new hires, layoffs and intra-organizational audits (Lorsch, 1995; Conger et al., 1998; Monks & Minow, 2004). This stands in stark contrast to the traditionally representational role of boards that fulfilled a legal requirement and a rubber stamp role more than anything else.

External dynamics have a major influence on making regular board evaluations more and more commonplace. This externally driven facet revolves around the value creating potential of boards and its improvement through evaluation (Belcourt & Kluge, 1999; Ingley &Van Der Walt, 2001; Lawler & Finegold, 2005).

Stakeholders from all sides are pushing toward boards that show dedicated control and leadership, suggest best practices and standardize codes, impose rules and demand higher professionalism (Ingley & Van Der Walt, 2002; Leblanc & Gillies, 2005). These pressures are exerted more and more frequently by stakeholders and governments. They want to hold boards accountable for their actions and make individual board members liable for organizational issues and actions (Kiel & Nicholson, 2005).

The conclusion of this chapter has to be that, given the relatively recent shift from representational to functional and the increasingly prevalent external factors that require improving the board's value-creating potential, the time to study board evaluations in depth and provide a methodological approach that yields objective excellence is now.

As we have seen, the urgency of the topic is also manifest in the consequential increase of scrutiny and pressure from regulators on board performance and the corporate board's justified existence. This pressure arises from several prevalent underlying factors of board failures, including namely the lack of oversight, excessive emphasis on short-term results and lack of emphasis on long-term value creation.

II - Boards of Directors in SMEs

Whereas the previous chapter discussed the need to enhance the board´s role and its strategic participation within the firm in general, this chapter focuses on the subject of small and medium sized companies.

First SMEs are defined, particularly SMEs in Spain and family owned business –one of the most significant types of SMEs. The role of the board of directors in SMEs is then discussed, together with their key contribution to this type of firms and the drivers behind the decision to implement a board. The third section of the chapter is devoted to SMEs' board composition and how it may vary depending on critical contingencies within the internal and external environments. The fourth section revolves around the concept of board empowerment and how empowered boards can contribute to advance the company towards its goals. Finally, the different options for SMEs regarding boards are presented. These include private boards, advisory boards and alternative boards.

SMEs' Definition

Over the past years research on Board of directors has focused mainly in the context of large and publicly held firms and little attention has been paid to small and medium sized companies. However, given that SMEs make up the bulk of firms that are active in an economy in nearly every country in the world, research on corporate governance for this segment became imperative to understanding corporate governance mechanisms that are able to positively influence the functioning and operational excellence of this type if company (Zahra & Pearce 1989; Borch & Huse 1993, Johannisson & Huse 2000). This is especially important in light of the results that corporate governance good practices can have on the organization as a whole, including value creation of assets, structural improvements that play out beneficially for the organization, finance improvements and the continuation of good business in the future.

The European commission defines SMEs as a category of micro, small and medium-sized enterprises, non-subsidiaries and independent, with less of 250 employees and an

annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro.

SMEs have an important economic position in most countries around the world, and they contribute greatly to worldwide economic production, employment and wealth creation (La Porta, Lopez-de-Silanes & Shleifer 1999; IFERA 2003).

SMEs are classified in three categories according to staff headcount and either turnover or balance sheet total.

Company category	Staff headcount	Turnover	or	Balance sheet total
Medium-sized	< 250	≤ € 50 m		≤ € 43 m
Small	< 50	≤ € 10 m		≤ € 10 m
Micro	< 10	≤ € 2 m		≤ € 2 m

SMEs in Spain. Spain has adopted these same categories to classify its SMEs, under the denomination of “PYME”, “Pequeñas y Medianas Empresas” in Spanish. According to the Central Company Directory (DIRCE) produced by INE (National Institute of Statics), on January 1, 2006 there were in Spain 3,232,706 SMEs, from which 3,2286,747 (99.88%) are PYMEs (between 0 and 249 employees). In comparison with the European Union, micro companies in Spain represent 95.7% of the total number of companies, 2.9 points above the available estimate for the UE in 2014 (92.8%).

In 2016, Spanish PYMEs were determining in the generation of business employment, accounting for 66,9% of total of workers, a figure that is similar to the UE average. SMEs, however, are often confronted with market imperfections, or simply realities. They frequently have difficulties in obtaining capital (financial and human) or credit, particularly in the early start-up phase. Furthermore, their restricted resources may also reduce access to new technologies or innovation (European Commission, 2005).

Family owned businesses, an important component of SMEs. Family owned businesses are the world's oldest and most pervasive type of company. There are many large and prestigious firms and conglomerates who are still controlled by the founding family: "Salvatore Ferragamo, Benetton, and Fiat Group in Italy; L'Oreal, Carrefour Group, LVMH, and Michelin in France; Samsung, Hyundai Motor, and LG Group in South Korea; BMW, and Siemens in Germany; Kikkoman, and Ito-Yokado in Japan; and, finally, Ford Motors Co, and Wal-Mart Stores in the United States". These are examples cited by the IFC (International Finance Corporation part of the World Bank Group), in its Family Business Governance Handbook (Third Edition, Copyright © 2011 International Finance Corporation).

Nevertheless, a high percentage of family owned companies constitute the bulk of SMEs in almost every country around the world. The IFC Handbook states that: "*In many countries, family businesses represent more than 70 percent of the overall businesses and play a key role in the economy growth and workforce employment. In Spain, for example, about 75 percent of the businesses are family-owned and contribute to 65 percent of the country's GNP on average. Similarly, family businesses contribute to about 60 percent of the aggregate GNP in Latin America"*.

Most family owned businesses have trouble surviving beyond their founder's life time. According to IFC, 95% of family businesses do not survive the third generation of ownership. This is due to the shortcomings of subsequent generations of owners who are not capable of managing the growth of the firm and the demands of a larger family. But, as the IFC points out, family owned companies "*can improve their odds of survival by setting the right governance structures in place and by starting the educational process of the subsequent generations in this area as soon as possible*".

There are several studies that have proved through their research that family businesses outperform non-family companies in major indicators such as sales, profits and other. According to the IFC:

> *A Thomson Financial study for Newsweek compared family firms to rivals on the six major indexes in Europe and showed that family companies outperformed their rivals on all of these indexes, from London's FTSE to Madrid's IBEX. Thomson Financial created a unique index for both family and non-family firms in each country, and tracked them over 10 years through*

December 2003. In Germany, the family index climbed 206 percent, while the non-family stocks increased just 47 percent. In France, the family index surged 203 percent, while its counterpart rose only 76 percent. Family businesses also outperformed their counterparts in Switzerland, Spain, Britain and Italy.

This success is due to the particular strengths of family owned companies, which according to the IFC, include:

- *Commitment*. As one would expect, families managing their own business show exceptional dedication to their firm, since their goal is to pass the family jewel to the next generation. Family members work harder and are prepared to reinvest a significant percentage of their profits to ensure the long-term success of their business.
- *Knowledge continuity*. Families are most interested in passing on the knowledge and know-how of their businesses to the next generation who will own the company in the future. They usually involve them in the business from quite a young age, thus attempting to ensure its long-term success.

- *Reliability and pride*. Family owned businesses associate their name to the success of the company and therefore take pride in offering quality products and services to their customers. Additionally, they also strive to maintain their reputation and work hard to keep other stakeholders -such as suppliers, employees and the community in general- satisfied.

However, family owned companies also have important weakness which often threaten their long-term survival. In fact, between 66% to 75% fail or are sold during the life of the founder or founders. The reasons for their failure are sometimes similar to non-family owned companies: lack of financing to be able to grow, poor management, or external factors such as major changes in the competitive environment. But there are some specific causes of failure that are typically associated with family owned businesses. According to the IFC, the most significant are:

- *Complexity*. The family factor adds a new dimension to the management of the firm which does not exist in their non-family owned counterparts. The interests of the different members of the family may differ and emotions are involved. For instance, one of the most frequent conflicts regards the payment of

dividends. Members of the family who are also company managers will want to reinvest a higher proportion of their profits in the business, while other members who are not part of the day-to-day operations will be more interested in receiving higher dividends.

- *Informality*. Since they are managed by its owner(s), family owned companies usually do not pay much attention to establishing formal operating and managerial procedures to run the firm. As they grow in size, scope and complexity, they become inefficient and its survival is threatened.

- *Lack of discipline*. This is another common trait of family owned companies. They do not take into consideration important strategic issues, such as CEO's succession plan, the definition and implementation of specific policies regarding employment of family members in the company or attracting and retaining skilled workers and highly qualified managers.

According to John Ward, *Creating Effective Boards for Private Enterprises* (Family Enterprise Publishers, 1991), as quoted by the IFC, there are several stages that family owned businesses go through. Each one of them has different governance challenges to face. This point of view is summarized in the table below:

Ownership Stage	**Dominant Shareholder Issues**
Stage 1: The Founder(s)	• Leadership transition • Succession • State planning
Stage 2: The Sibling Partnership	• Maintaining teamwork and harmony • Sustaining family ownership • Succession
Stage 3: The Cousin Confederation	• Allocation of corporate capital: dividends, debt, and profit levels

	• Shareholder liquidity • Family conflict resolution • Family participation and role • Family vision and mission • Family linkage with the business

Source: IFC (International Finance Corporation part of the World Bank Group), Family Business Governance Handbook (Third Edition, Copyright © 2011 International Finance Corporation)

As the family goes beyond the founder(s) stage, matters become more complex. More members of the family will probably be involved in the business and, at that time, as the IFC Handbook notes: "*It becomes mandatory then to establish a clear family governance structure that will bring discipline among family members, prevent potential conflicts, and ensure the continuity of the business*".

This governance structure should have as its main goal to excel at communicating, to all members of the family, the culture, values and long-term vision for the company. It is of the utmost importance to keep posted those members of the family who are not involved in the day-to-day activities of the business. They should know about major successes, challenges faced and the strategic direction being followed.

Other crucial topics that the whole family should know about are the specific policies and decisions applying to such issues as family members' employment, dividends and other perks that they may receive from the business. Formal communication channels should be established and the family should come together when major decisions are to be made.

According to the IFC, "*developing such a governance structure will help build trust among family members (especially between those inside and outside of the business), and unify the family thus increasing the viability chances of the business*". The Handbook notes too that there are basically two instruments to implement a family governance structure: a family constitution and family institutions:

> *The family constitution is a statement of the principles that outline the family commitment to core values, vision, and mission of the business. The constitution also defines the roles, compositions, and powers of key governance bodies of the*

business: family members/shareholders, management, and board of directors. In addition, the family constitution defines the relationships among the governance bodies and how family members can meaningfully participate in the governance of their business.

Family constitutions are written documents that change and evolve when new family or business circumstances so demand. They deal with critical issues such as the authority of the different bodies and the relationships between them, the policy about family members' employment, share transfers or CEO succession.

Family institutions may adopt the form of family meetings, family assemblies and family councils. They may also include several additional committees such as an Education Committee, Career Planning Committee, Shares Redemption Committee or even a Family Reunion and Recreational Committee (IFC Handbook, 2011).

To each development stage of the family owned company corresponds a particular institution, as shown in the table below:

	Family Meeting	**Family Assembly**	**Family Council**
Number of Meetings	Depends on the stage of the business' development. When the business is growing fast, it can be as frequent as once a week.	1-2 times a year	2-6 times a year
Main Activities	• Communication of family values and vision. • Discussion and generation of new business ideas. • Preparation of the next business leader(s)	• Discussion and communication of ideas, disagreements, and vision. • Approval of major family related policies and procedures. • Education of family members on business issues • Election of family council and other company committees' members.	• Conflict resolution. • Development of the major family related policies and procedures. • Planning. • Education. • Coordination of the work with the management and the board and balancing the business and the family
Stage	Founder(s)	Sibling partnership/Cousin Confederation	Sibling partnership/Cousin Confederation
Status	Usually informal	Formal	Formal
Membership	Usually open to all family members. Additional membership criteria may be set by the founder(s).	Usually open to all family members. Additional membership criteria may be set by the founder(s).	Family members elected by the family assembly. Selections criteria defined by the family.
Size	Small size since family still at founder(s) stage. Usually 6-12 family members.	Depends on the size of the family and membership criteria.	Depends on criteria set up for the membership. Ideally 5-9 members.

Source: IFC (International Finance Corporation part of the World Bank Group), Family Business Governance Handbook (Third Edition, Copyright © 2011 International Finance Corporation)

Role of the Board of Directors in SMEs

Boards: key contributors to SMEs. The majority stockholder of a private company decided to implement a board because "*He wanted objective input as to the strategic direction of his company, as well as to other corporate matters*" and it was a great success. This is an example cited by Theodore F. di Stefano in a brief article: Should a Private Company Have a Board of Directors? (*E-Commerce Times*, *Feb 8, 2008*).

Another example from the same article, in this case a negative one, portrays a company in the healthcare industry that ended up filing for bankruptcy, after 10 years of successful operations and having reached sales of US$ 500 million annually. The company was owned by its brilliant founder whose mistake was to surround himself by people who did not dare to criticize him and "*made him feel that he was infallible*". In Di Stefano's opinion: "*An outside board of directors would have… tremendously aided this company not only to stay out of debt, but also to grow and prosper".*

According to Oswald, R Viva (*2011*) boards of directors are key contributors to the success of SMEs, especially in high-tech start-ups and fast-growing companies. Boards composed by experienced businesspersons, investors and others are a source of guidance and expertise in the direction of the venture. Boards' main role in SMEs is to ensure accountability. They hold management accountable for achieving the business plan, creating shareholder value and assisting the owner/CEO in growing the enterprise. They exert enough power to oversee the management team and supplant it in case of underperformance. Boards provide guidance and advice and if they are strong enough, they can support young companies to build credibility in the outside world.

Viva emphasizes that:

> *"Most owners of small or midsize business perceive the keys to success and long-term growth to be new products, new markets and solid management. Most small businesses don't have a board of directors because they cannot afford one and because their owners don't think they need one. In fact, the perception of most small business owners is that "a board of directors is only for big business." This cannot be further from the truth though, as most entrepreneurs desperately need a source of advice and support, and the accountability of*

having to report to someone."

Some argue that the fact that business owners and higher management who have nobody above them and thus nobody they have to report to create slow courses of action and promotes inactivity. In this regard, many business people decide to start their own businesses so that they don't have to report to anyone anymore. A potential downside of this phenomenon, however, is that business owners who become too accustomed to not having to justify and responsibly explain themselves and their actions tend to be less accountable and thus have more propensity to fail and be complacent with their business.

Business leaders who fall into the accountability trap tend to lose the overview over their business operations and get caught up in banal tasks that do not contribute to growth and core value creation activities. A disproportionate focus on tasks and activities that are seen as enjoyable and pleasant by the business owners outweighs the attention that should be devoted to leadership and visionary business focus in these situations. In the end, this often leads to frustrated owners, stagnating business, burn-out symptoms and, in some cases, business failure.

Viva notes that the business world leaves no margin for error and entrepreneurs who just start out in the endeavor of making ends meet with an own business often find themselves in rather tough situations, especially if the new business owner has no prior managerial experience. The mentorship of more experienced business people that have held executive positions and have seen many businesses from the inside is invaluable for beginners in the harsh business world. It has to be noted that the majority of entrepreneurs lack the necessary skills and especially the experience needed to minimize the risk when starting a new business. To use Viva's own words:

> *The entrepreneur, who starts a business on a great idea but has no managerial experience, can be "lost" in the hard world of business. Seasoned entrepreneurial executives who have been through it all before can guide them and help them avoid pitfalls. It is a fact that very few entrepreneurs have all skills needed in running a business. It's rare for someone to understand administration, operations, finance, sales and marketing, and human resources, and to be a great leader as well. So it makes sense to find board members who can complement the skills of the entrepreneur.*

Moreover, in many start-ups the board is composed by the founder and maybe the accountant, legal counselor, family and friends. However, Viva contends that it could be highly beneficial to include outside directors in the board -not being family or friends- since they can bring counsel and strategically guide the firm. This means also that the founders have to renounce to part of their power by delegating it to their board.

Finally, board of peers can counteract the "lonely at the top" or alienation feeling many business leaders of small enterprises experience. Outside boards facilitate an open space for discussion where CEOs can candidly express their ideas, concerns, plans and those internal issues that cannot be openly discussed with employees.

Factors driving the implementation of a board. Wim Voordeckers, Anita Van Gils and Jeroen Van den Heuvel -from the Research Center KIZOK at Hasselt University and Maastricht University- in their paper: Board Composition in Small and Medium Sized Family Firms (December 20, 2006) point out to the various drivers that decide the implementation of a board in family owned companies. Among them they include:

- The CEO characteristics.
- The complexity of the family.
- Generational transition and
- Family company objectives

The CEO is usually the most influential person in a family owned business, thus he or she is the individual who decides whether or not to be assisted by a board including external directors. The Belgian authors contend that the greater the power of the CEO, the lesser the probability that he or she would decide in favor of a board with independent directors. The level of education is also a determining factor, since a highly educated CEO/owner will also be less inclined to include external directors in the company's board.

The number of family members working in the company is another key issue. When there are several members of the family working and/or holding management positions in the family business, disagreements and differing points of view may cause more or

less serious problems. Conflict resolution may be helped by the assistance of a board that includes independent directors. They can provide additional perspectives, play an arbitrator's role, if needed, and generally contribute to add value to the firm, provided that they are effective in their board work.

Generational transition can be a threat to the survival of the family owned company. The issue of succession is a fundamental concern for family business owners. "*The succession process in a family firm is often accompanied with a power struggle*" the authors argue and cite Barnes and Hershon (1994) as backing this point of view. Firms in a transitional generation stage are consequently more likely to seek the assistance of independent board members. The paper also highlights the following perspectives:

> *"Fiegener et al. (2000b) link CEO generational stakes to board composition. They point out that first-generation CEOs compose a more dependent board than nonfounder CEOs because they have a stronger emotional need to protect their discretion. Opposing arguments -against outside directors in multi-generation family firms- are presented by Westhead et al. (2002). They argue that outside directors may focus too much on the financial performance of the firm rather than upon the non-pecuniary objectives of family members. Overall, we conclude that outside directors can provide family firms with arbitration (Whisler 1988), new expertise and experience to cope with increasing structural form complexity.*

Regarding family company objectives, the authors highlight the fact that family owned businesses usually have different goals from non-family firms. Besides profits, they consider of primary importance objectives such as maintaining the company's ownership within the family, providing a means of living for members of the family who become employees or hold managerial positions, maintaining the family's financial independence and the family's harmony. Growth, expansion or innovation may not be considered crucial in family owned companies. If and when the CEO/owner starts thinking about these questions becomes, perhaps, the moment when they also consider the possibility of adding external independent directors to their board.

Board Composition in SMEs

Oswald Viva (2011) considers that it is important for small companies to have a clearly defined purpose for their board and the CEO must devote his or her effort to select the right board members to fit the purpose. Board members must have the ability to assist with managing the company when needed, share experience and skills with management and clearly understand organizational goals, needs, values and mission statement. Board members that increase the effectiveness of the board are typically industry veterans or experienced business leaders that have gone through the process of building, managing and/or running a company oriented toward steady growth, and thus have developed an entrepreneurial awareness of the operational reality of a business with all its challenges and demands.

Viva also warns us about the high risk of ineffectiveness and failure in situations when board members include certified public accountants (CPAs), lawyers or other working professionals or contractors that have an existing business relationship with the company at hand in their respective field of work and expertise. If an individual's source of income comes from the same company that has to be evaluated by that individual, the assessments, feedback and opinions are much more likely to be biased in favor of the continuation of the business relationship that the individual has with the company, because it is in his or her best interest not to lose that source of revenue.

These instances of conflict of interest are a potential pitfall that has to be carefully avoided. Moreover, if the standard answer by the members of the board regarding any issues that come up during the discussions is "yes", the company leadership might feel affirmation and confirmation of the course of action they are following, but they do not get closer to uncovering potentially detrimental dynamics and problems in their business. Hence, a critical, independent outsider is needed.

Additionally, there should be congruence between the owner of the company and the members of the board. They should share general values and paradigms in order to prevent miscommunication, misalignment or unconstructive conflict. Rapport should also be taken into account. As Viva states: "*It is important to recruit board members that have similar values to those of the CEO so that the board would not be a mismatch with the culture created by the owner/CEO. He/she must be clear about the expectations and must make sure the potential board members agree with them. Personal chemistry*

does matter; it makes sense to take the time to find qualified outsiders who have a good rapport with the company's leadership and an informed interest in its industry's challenges.

Finally, expectations should be clearly spelled from the very beginning and it is recommendable to obtain explicit agreement from all board members regarding expectations to avoid potential misunderstandings.

Having a board does not automatically mean that things will improve. A group of industry-savvy and experienced directors can be highly beneficial to company owners and the company as a whole, but the full benefits and positive results only come when the owners of the company and the rest of the staff are willing to open up and honestly tell the truth about the momentary situation of the company. Subsequently, and by no means less important, the advice and feedback as well as the corresponding calls for action by the board members has to be taken extremely seriously and acted upon with due diligence.

The full scope of activities and operational issues has to be communicated in the most complete possible manner and on a regular basis, whether it concerns positive or negative issues.

Board empowerment in SMEs

Gabrielsson (2011) investigated/studied the role and contribution of externally recruited boards in small and entrepreneurial firms. He assessed how different board role theories -agency theory, resource based view of the firm, and resource dependence theory, which will be explained later in this work- can be applied to understand the multiple roles that "outside" directors can play in family firms, venture capital-backed firms and other SMEs. As the concept of "outside director" diverges in the different theories and in different real-life circumstances, there is a need to have a mindful and balanced use of theories to comprehend the role and contribution of "outside" directors in SMEs.

Having outside directors in the company can bring many advantages. Those advantages include but are not limited to being able to benefit from management expertise and competent advice, the generation of ideas that bring value to the company, new fresh

paradigms and viewpoints that change problematic practices and prevent groupthink, as well as advancing the network of the company in a more diversified direction (Schwartz & Barnes, 1991; Daily & Dalton, 1992; Borch & Huse, 1993; Daily & Dalton, 1993; Watkins & Shen, 1997; Huse, 1998).

Gabrielsson (2011) contends that literature has focused its attention in board composition and the benefits of director involvement to evaluate the role of board in small companies. However, this approach is limited when trying to explain how boards become activated and empowered. According to Gabrielsson, board empowerment in small companies indicates the extent to which the board is able to exert influence on how the company resources are being allocated across the organization as well as on decisions taken regarding the strategy and direction of the company. Board empowerment is relevant because it may play a pivotal role in improving the performance across the entire organization and in generating positive change.

The author also researched how boards' composition may vary depending on critical contingencies in the internal and external environment. More specifically, empowerment of the board refers to the elements that foster a sense of power and effectiveness as well as an ability and willingness to act. When the power over strategic decisions is unbalanced and concentrated in the CEO, the board is less likely to influence the current design of company strategies and future performance. For example, the number of directors from outside the organization is a relevant factor. There has to be an appropriate number of external directors and a separation of responsibilities for the roles of the chairman of the board and the CEO of the company.

Directors in empowered boards have the ability to influence the strategic direction of the company and they are independent and powerful enough to control managerial and company performance. For instance, it becomes easier to balance the interests of all the different stakeholders involved. Strategies and goals can powerfully be aligned and refocused so that there will be no problems in situations when there is a conflict between the potentially impulsive, non-rational or emotional behavior by the executive management level and the broader direction and goals the company is pursuing. Empowered in this way, the board may add substantial value to the overall organization and its goals. It will also able to provide networking opportunities as well as general advice, expertise and high-quality information. This also helps to create complementary

and synergistic checks and balances between the board and the company's management.

Boards acquire an empowered role in the sense that they control what is going on and provide a service to the organization that cannot be obtained otherwise. By contrast, a board that has nothing to say and is dependent on company management exerts little influence on the overall functioning of the business, including its strategy, the decision-making processes and the company owner's power to implement changes at will (Huse, 1995).

According to Gabrielsson (2011), small companies feature a particular kind of composition in their board of directors. Crucial contingencies in the external and internal environment will particularly affect the composition of the board in small companies. The author contributes to a particular research topic that has been largely unexplored in literature. His hypotheses are set out below:

> *"H1: Multi-generation family businesses are positively related to board empowerment in small companies.*
>
> *H2: Equity ownership by outsiders is positively related to board empowerment in small companies.*
>
> *H3: The size of the company is positively related to board empowerment in small companies.*
>
> *H4: The technology level of the firm is positively related to board empowerment in small companies.*
>
> *H5: Experiencing growth is positively related to board empowerment in small companies.*
>
> *H6: Involvement in international activities is positively related to board empowerment in small companies".* Gabrielsson (2011, p. 3).

The most important findings of Gabrielsson's study (2011) include the fact that external stakeholders who have a vested interest in the company, own shares or are otherwise significantly involved in the business operations exert a substantial amount of pressure on the ability of boards in small organizations to reach a state of empowerment. Furthermore, external pressures and the need for resources also contribute to a more

empowered and more effective board. These two dynamics, enhancing empowerment through external pressures and resource needs, showcase that the conscious composition of a board may actually be seen as an instrument to adapt the organization to contingent factors and issues that momentarily surface in its existence and functioning (Zahra & Pearce, 1989; Huse, 2000).

Furthermore, these two dynamics of empowerment may influence the behavior and actions of board directors in different ways. On the one hand, external pressures may translate into stakeholders outside the organization using and leveraging the group of directors as a tool to monitor what is going on with and inside the organization. Directors that act in such an instrumental manner for outside stakeholders are facilitating the process of controlling the performance of the organization's management and the company as a whole. On the other hand, considering the resource needs of an organization that stems from the perspective of stakeholders inside the company, threats to the environment or uncertain marketplace situations can be responded to in this way -by leveraging the board and its function within the organization.

Several studies suggest that the personal professional history of a director, his or her educational background and experience, as well as personal paradigms, attitudes, values and belief systems may be quite significant in board effectiveness and what kind of outcomes and results can be achieved (Zahra & Pearce, 1989; Forbes & Milliken, 1999). One study found, for instance, that particular sectors within an economy and their respective percentual representation were correlated with the proportional representation of the corresponding economically motivated interests within the group of directors on the board (Pfeffer, 1974).

Given the fact that the most powerful and influential actors within a company usually shape the strategy, are determining in performance levels and other outcomes and outputs of a company (Hambrick & Mason, 1984), more research in this area is definitely desirable and relevant. This kind of future research should furthermore focus on letting the traditional research paradigm behind and implement a perspective stemming from cognition studies, social psychology and behavioral economics, a view that is also echoed by Huse (1993) as well as Forbes and Milliken (1999). Finally, belief systems, motivational perspectives of board members and other contingencies pertinent to the study of boards of directors should also not be left out of the picture (Huse, 2000).

In a similar line of research, Corbetta and Salvatto (2004) -from a contingency perspective- analyze the determinants of a board's effectiveness in providing the firm with important resources. They argue that board capital includes human and social capital. The first one refers to directors' experience, expertise, knowledge, skills and reputation; and social capital is related to the current and potential networks within and through a board of directors.

Board capital depends on three variables: board size, directors' background, and board activism. The higher the number of directors in the board, the wider the resources that can be provided to the firm such as skills and inter-organizational links. However, the provision of resources depends also on the composition of the board: directors' personal and professional background is a crucial component of a boards' capital and, hence, of their ability to provide resources. Consequently, a large board composed only by inside directors will provide fewer resources and network links than a large board composed by insiders and outsiders such as business experts, support specialists and individuals with great influence in the community.

Lastly, the authors contend that the provision of resources does not depend only on the size and composition of the board, but also on the procedural aspects of board capital: frequency and time devoted to board meetings, selection of topics on the agenda, type and quality of information available to directors, etc. In their view, board capital is positively associated with the provision of resources. Boards can provide resources that help curtail the dependency of the organization from the environment and the associated uncertainty for the firm. Additionally, the very existence and performance continuity largely depends on how the board of directors allocate resources within the firm, which in turn brings down costs and again helps the company in its way forward.

Types of Boards: Private Boards, Advisory Boards and Alternative Boards

For SME's, private boards, advisory boards and alternative boards are the three categories from which they can choose when they decide to be assisted by a board that goes beyond the "paper board" -the first option usually implemented by small

companies, whether or not they are family owned.

Oswald Viva (2011) points out that when making the decision to implement an outside board of directors, the CEO or entrepreneur of the small company must have a deep understanding of the value that the board can bring to the firm, a well-defined purpose and expectations to guide the selection and choose the best alternative for the business.

Private boards: they have a fiduciary duty. This is a paid board with outside directors who supervise the progress of the firm. They review the CEO and the management team and they have a margin of power to act in case of problems. If the board meets frequently it can also provide permanent support and participate in the strategic decision making of the company. The board can also facilitate links with experienced people who can bring knowledge and expertise to the table. The working board can also counter the potential alienation the CEO may suffer in his/her leadership role.

Furthermore, according to Viva, the board can act as a discipline mechanism in a closed stock company since the management team has to report to it the main business operations. Additionally, the board can play a mediator and problem solver role in the small or midsized firm, especially when conflicts arise among family members. Another additional advantage of private external boards is that they can help to ensure the visibility of the firm in the outside world, linking it with financing sources, acquisition targets, strategic partnership opportunities, and with the community in general.

On the other hand, private boards may have some drawbacks. They demand extra time from the CEO/owner and other company managers. The recruiting process, the preparation of board packs of information, the planning of agendas and drawing advisers to meetings are some of the activities inherent to having a board in the company. In addition, as already mentioned before, some CEOs of privately held corporations may fear to lose their autonomy in the presence of independent directors.

It is also worth noting that directors of private boards have a fiduciary duty to the shareholders and the corporation. they can therefore be subject to potential lawsuits. For this reason, the company should cover the board with D&O (Directors & Officers) liability insurance, according to Viva. However, there is an optional type of board –the

informal advisory board– who is exempt of these risks and duties and thus constitutes a more viable alternative for many entrepreneurs.

Advisory boards: a recommended option. According to IFC's in its Family Business Governance Handbook: "*The advisory board is a group of experienced and respected individuals that many family businesses form when their own boards of directors remain only composed of family members and company senior managers*".

Advisory boards are considered a "*compromise solution*" for family owned businesses. They offer the advantage of adding a broader, independent perspective to the company's board, usually formed by the CEO/owner and key managers of the family owned business.

At their inception family owned companies establish a board of directors to comply with legal requirements. They are the so called "paper boards" and their main task is approving the company's financial statements, dividend distribution and other matters that the law demands be approved by the board. This type of board usually meets once or twice a year and are for the most part composed of family members and sometimes also include senior managers trusted by the family owners. But quite often senior managers are at the same time board directors and owners. The same individuals perform the three functions. As IFC's Handbook points out: "*Such a governance structure adds little value to the family business as each element of this structure (board, management, and family) could separately play a more active and constructive role within the governance of the company. As a consequence, roles are mixed, possibly leading to conflicts and inefficiencies in overseeing the company and its strategic decisions*".

The advisory board is a useful step further in the family owned business:

> *"Many family businesses recognize the need for an independent board, but are also uncomfortable sharing sensitive company information and decision-making power with a group of outsiders. These family businesses usually opt for the creation of advisory boards as a way of getting outside advice and expertise while keeping control over the company's real board. Over time and once the family sees the added value of the advisory board, some of its members are often*

*invited to join the company's board of directors". (*IFC Handbook, 2011)

Oswald Viva (2011) considers that advisory boards can bring great benefits, in particular, to starting business since they can provide different, out of the box thinking perspectives and expertise from their different industry backgrounds. Entrepreneurs can get valuable outside guidance from a customized board of advisers. Having a board of outside, diverse and active directors is the path to the long-term stability of the firm. A company that strives to constantly evolve and innovate depends on outside sources of advice and input.

Alternative boards: useful and affordable. One desirable option when it comes to alternative boards is the creation of special groups of quasi directors as an outsourced project lead by a third party firm that is especially equipped, trained and experienced to facilitate such endeavors.

The specialized company providing the service relies on a "pool" of "directors" and always assigns a facilitator to each client company requiring the service. According to Viva, "director's" "*membership is by invitation only based on each candidate's qualifications. The facilitator confers with each member prior to the monthly group meetings, and identifies issues to be placed on the agenda for timely discussion. These standards result in compatible and committed groups; members typically stay in the system an average of well in excess of two years".*

A proven track record of improvements and positive results should be corroborated and these firms should be able to showcase past successes with similar companies and board compositions. An important advantage that comes with this approach is the advice and synergistic facilitation of the process by a group of diversely experienced subject matter experts. They are optimally equipped to independently solve problems that have long been overdue to be solved but were stagnating, simply because a more global perspective and solution approach was missing so far. Small and medium-sized business in particular can benefit from this type of approach. It provides new sources of motivation and inspiration that can then be applied to the own set of problems that the firm is grappling with. Lastly, considering the often difficult financial situation of small businesses, such board alternatives are usually also quite affordable and deliver high

value for the cost they incur. If the context is right, it is certainly recommendable.

These alternative boards *are composed of owners and leaders of non-competing businesses of similar size. They meet monthly for 3 or 4 hours to discuss problems and opportunities in a relaxed and confidential atmosphere. Members are matched according to business size, type and complexity of the businesses, experience, and even personalities. Each board usually has members operating businesses in different industries.*

The meetings center on owners' common interests and problems as well as concerns and opportunities. The meetings are headed by a trained facilitator with extensive business and management experience and business owners receive support, advice, useful perspectives and as Viva points out, the most important advantage they get is accountability: "*The accountability and advice are more valuable because they come from fellow successful business owners who most likely have faced or will face similar problems or issues. The dynamics of the meeting keeps the participants moving in the right direction, because all the business owners in the group understand each other's formulas for success and what the individual and collective needs are".*

In conclusion, this chapter demonstrates the importance of considering small and medium sized companies given their global and massively prolific presence as well as their undeniable contribution to economic growth. Having a board of directors can contribute much to this type of businesses. They can provide numerous resources to the firm and its functioning, such as hands on and industry-specific expertise, counsel, financing sources, strategic partnership opportunities and so forth.

However, the type, size and composition of the board will depend on the current situation and needs of each company. By no means can SMEs afford expensive private boards. Many others may be reluctant to bring outsiders to the potentially family-owned firm and boards could also be perceived as extra work and a waste of resources to entrepreneurs that have no history with boards of directors. Given that SMEs are the economic backbone of the world economy, it is crucially important to draw attention to this matter and insist on the numerous benefits a carefully catered and contextually designed board of directors can afford. In the next chapter of this dissertation, the concept of board evaluation will be defined and linked to the different board theories.

III. Evaluation Theories

This chapter is devoted to the various evaluation theories. First it discusses the concept of evaluation more commonly used today, particularly in listed companies, and why it seems to be of little impact. Then it reviews the main board theories and how they deal with the subject of board evaluations. Agency theory, Stewardship, Resource Dependence Theory and Stakeholder Theory are each reviewed.

The next section of the chapter presents the contributions to the subject of board evaluations by theorists and researchers such as Kiel and Nicholson, Susan Schulz, Huse and Gabrielsson, Janicke Rasmussen, and Cohn and Kess. The point of view of each one reviewed. This section of chapter III also includes the more practical perspective of consulting firm Deloitte. They note what they believe to be the three top functions of any board: providing strategic direction for the company, management control and monitoring, and providing support and advice. Evaluations should thus examine these roles and how effectively they are performed.

The Concept of Evaluation

Board evaluations have been widely recognized as good practice in corporate governance and as a contributor to value creation and improvement of effectiveness of boards and its activities. Periodic evaluations have become part of the acceptable corporate governance context and, if performed properly, serve as a tool to improve board's effectiveness (Cohn and Kess, 2016).

A board evaluation is about appraising a board´s work, assessing its effectiveness against expected levels of performance. The aim is to identify potential problems and to develop interventions designed to align actual and desired performance levels (Kiel and Nicholson, 2004). Boards may be evaluated as a whole but they can apply to each individual director. The evaluation can be conducted by the board itself or by someone external on behalf of the board (Minichilli, A.; J. Gabrielsson; and M. Huse. 2007). According to Deloitte (2014) Board evaluation is an annual practice for many corporations by choice or to comply with regulations. The methodology and the format

of evaluation are flexible according to contextual factors of individual company. Evaluations vary according to company's requirements, specific conditions, corporate structure, lifecycle, culture, etc.

Although there is no common format or “one best way” universally accepted to evaluate boards of directors, performing board evaluations is not simply a box-ticking exercise, (Deloitte. 2014; Minichilli, A.; J. Gabrielsson; and M. Huse. 2007; *Cohn and Kess, 2016*).

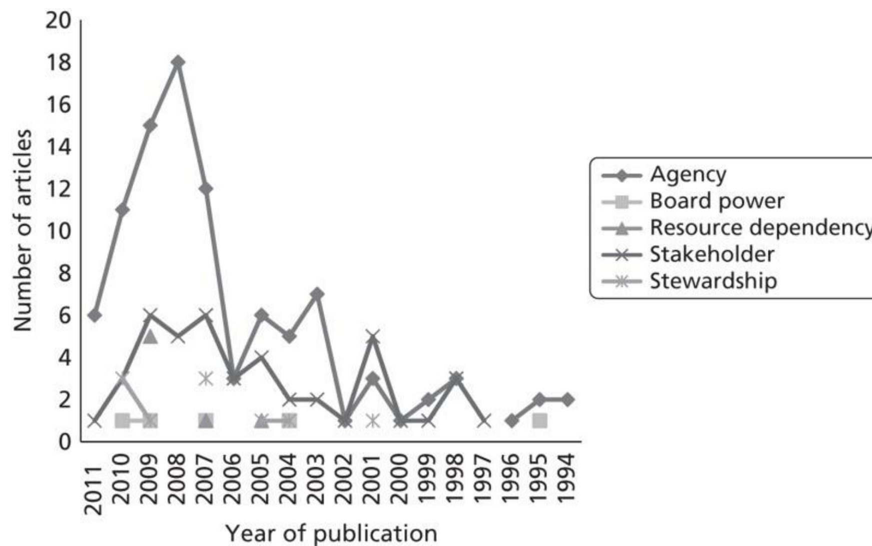
Board evaluations will have different designs according to decisions about the agent who evaluates the board, the addressee and other stakeholders, for whom the board is evaluated, its content and the modalities of evaluations a board adopts. A systematic and comprehensive approach in the design of a board evaluation system must ensure a fit between all these elements (Huse & Gabrielsson, 2012)

According to Cohn and Kess (2016) there are series of key factors to be taken into consideration when designing the optimal evaluation method for a board. First, the culture and internal dynamics are important drivers of the evaluation methodology selected. An acknowledgement of these factors in the evaluation design can help to gain directors trust and therefore, a will to participate. Secondly, the needs and the situation of the company at each precise moment should be considered. This is applicable for example to transitional periods where the company is affected by changes in its board of directors or management staff; these circumstances require a different evaluation process.

Other priority factor to be considered is the company’s underlying objective in conducting the evaluation. The evaluation´s aim may be to comply with the company’s governance guidelines or with external regulations/codes, or to assess specific issues or perceived deficiencies. Understanding the goal(s) of the board evaluation should guide the approach to be taken and the selection of the best suited tools in the evaluation design to achieve the company’s objectives.

Evaluation as Part of Board Theories

The interest of investors, the business community and regulators has driven the research and publications of many papers, articles and books on board governance, board performance, board roles, board processes… The following chart shows the great increase in the number of publications on the subject.



Source: Chambers N, Harvey G, Mannion R, et al. Towards a framework for enhancing the performance of NHS boards: a synthesis of the evidence about board governance, board effectiveness and board development. Southampton (UK): NIHR Journals Library; 2013 Oct. (*Health Services and Delivery Research*, No. 1.6.).

The aim of this section is to determine to what extent the various theoretical frameworks devote their attention to the evaluation of board performance.

Agency Theory. Berle and Means in 1932 were the first to refer to the fact that shareholder and management interests were likely to differ. The Agency theory about boards of directors was thus the first one postulated. Later, in 1976, it was more extensively developed by Jensen and Meckling. It deals basically with the organization and ownership of property and the distribution of power related to it. As the shareholder base grows in size, shareholders −principals− lose control of the company. They thus decide to put in place professional managers to take care of the business. Over time managers −agents− end up pursuing their own interest at the expense of the principals (shareholders). When such a conflict of interest arises there are costs incurred for the principals due to agents' underperformance, such costs are referred to as agency costs.

It is in the interest of the principals to minimize agency costs.

The principles of agency theory are on the basis of regulatory developments in the United States (New York Stock Exchange, NASDAQ, SEC, Sarbanes-Oxley Act, 2002) and other countries (see, for instance, The UK corporate governance code. London: Financial Reporting Council; 2010). N. Chambers et al. (2013) state that this British corporate governance code "*continues to set the tone for UK business today*" and that it represents a "*deep-rooted agency view of governance that had its origins in dealing with the aftermath of UK governance failures of that decade…*"

Agency theory is also the dominant principle behind corporate governance practice (Daily et al., 2003; Dalton et al., 1998). This dominance stems from the fact that agency theory provided the first plausible and theoretically sound explanation for the issues related to the prevalent separation between control and ownership in big public enterprises (Jensen and Meckling, 1976). However, this theoretical one-sidedness comes with two downsides: First, the control tasks and control functions a board performs have been overemphasized in the literature given the agency role it ought to perform according to the theory. Second, the most extended idea is that a board can only be effective, if it is independent from management or managing groups within the company it operates within (Minichili, 2009; Roberts, McNulty and Stiles, 2005).

The theory emphasizes the monitoring and control role of the board through processes such as external audits or reporting requirements. The effectiveness of governing boards is measured by the extent of control they have on the management of their organizations. The aim is to minimize the possibilities of agents seeking their own interest and of poor performance on their part. Among other control means for the board, Fama and Jensen (1983, 1998), suggest that "*initiation and implementation of decisions*" be separated from "*ratification and monitoring decisions*", that is to say that decision management is in the hands of agents, while decision control pertains to the board.

According to Agency theory, the overall effectiveness of the board depends on a good understanding of the shareholders interest, the size of the board and its independence. Board size is most relevant, since too many members and committees within the board can slow down the decision-making process and increase agency costs. Independent directors are needed to ensure objectivity when monitoring the management.

Independence of the CEO function and the Chairman of the board is a crucial underlying principle of the Agency approach.

Recently, Dalton et al. (2007) have reviewed the three mechanisms that are currently used to mitigate the problem inherent to the Agency theory and thus make the board more effective. These include: "*(a) independence, (b) equity, and (c) the market for corporate control*". The authors contend that the three elements are not as efficient as one may think.

On independence, for instance, it is worth noting the following paragraph:

"Consider, for example, that a leadership structure with a separate CEO and board chairperson is not necessarily indicative of independence. In fact, in the clear majority of cases (67%), the person who is the "separate" board chairperson is the former CEO of the company (Spencer Stuart, 2005b). Actually, even the "67%" is understated, because the misspecification is broader yet. Not only are these "independent" chairpersons former CEOs, they are also company founders, former CEOs of acquired/merged companies, or persons otherwise connected to the focal company beyond their service as directors and members of the board (Monks & Minow, 2004)".

On the use of equity ownership to align the interests of managers to those of the shareholders, Dalton and his co-authors argue that:

"In many companies, both high-ranking officers and directors were subject to a requirement to hold a certain level of equity in the firm. Even so, these officers and board members did not directly purchase this equity. Instead, the firm loaned officers and board members sufficient funds to fulfill the equity requirement. Furthermore, the firm subsequently forgave these loans (e.g., Dalton & Daily, 2001; Henderson & Spindler, 2005; Knutt, 2005). SOX Section 402, however, explicitly forbids companies to extend such loans to officers and directors. Equity obtained in this manner does not reflect the spirit of linking shareholder interests with those of the officers and directors of the firm".

The market for corporate control is supposed to rein in managers through the threat of potential mergers and acquisitions. In this respect, the above-mentioned article states:

"The market for corporate control has been described as a "blunt instrument" for

resolving serious performance failures (Hawley & Williams, 2000). The extremely poor performance of firms at the time the market for corporate control becomes active serves as evidence of the failure of other governance mechanisms. Thus, the market for corporate control does not prevent performance failures; rather, it is used to correct them after they have already occurred, thereby rendering it effective ex post rather than ex ante. We would concede, however, that an active market for corporate control and a viable threat of takeover may dampen some opportunistic behavior."

The authors summarize their conclusions stating that:

"There is, for example, no evidence to suggest that the independence in the composition of boards of directors is related to corporate financial performance.

With regard to equity holdings, the empirical evidence is similarly enervated [...] *the market for corporate control was largely ineffective and is likely no longer active. Thus, it has done little to truly mitigate agency problems, and in fact, may have encouraged agency problems in some cases".*

Although pervasive in explaining the realities of the corporate world and its functioning, Agent Theory is not of great help when trying to measure the effectiveness of board of directors' performance.

Within the framework of this theory, the main criteria applied to evaluate board performance are economic ones directly related to the principle of maximizing value for shareholders. Nevertheless, this is currently being questioned by researchers such as Sumantra Ghoshal (Ghoshal, 2005). Ghoshal questions the effectiveness of Agency theory and states that: *"What is interesting is that agency theory, which underlies the entire intellectual edifice in support of shareholder value maximization, has little explanatory or predictive power".* Its "*prescriptions*": *("Expand the number and influence of independent directors on corporate boards so that they can effectively police management; split the roles of the chairman of the board and the chief executive officer so as to reduce the power of the latter; create markets for corporate control, that is, for hostile takeovers, so that raiders can get rid of wasteful managers; and pay managers in stock options to ensure that they relentlessly pursue the interests of the shareholders")* have none of " *the predicted effects on corporate performance*". One could also add that it does not contribute the means to evaluate board performance.

Stewardship Theory. In total contrast with the first theory reviewed, the Stewardship point of view does not put its emphasis on control and monitoring but on cooperation between company managers and its shareholders. This theory is grounded in psychology and sociology and intents to go beyond the limited concept of the individual as a self-interest seeker. It was first developed by Donaldson (1990), Donaldson & Davis (1991) and further expanded by Davis et al. (1997) and Chris Cornforth (2003).

Directors, as stewards, act in the best interest of their principals –the shareholders. The Stewardship theory is based on the assumption that stewards will follow collectivist behaviors, since this type of behavior has greater utility than individualistic behavior. The steward places higher value on cooperation than on self-interest. Alignment of interests between stewards and principals is the outcome resulting from a relationship based on trust, reputation and collective goals. According to Davis, 1991/1997, stewards are motivated by "*a need to achieve, to gain intrinsic satisfaction through successfully performing inherently challenging work, to exercise responsibility and authority, and thereby gain recognition from peers and bosses*".

The dual function of the CEO who also heads the board of directors is advocated by the theory as is the board strategic role. When the CEO chairs the board, the result is a strong and unified leadership, defenders of this concept contend. On the board's role as strategist, they believe that boards help to shape the mission, culture and values of the company; to understand the market environment and extract the relevant consequences for company's strategy.

Although not prevalent among scholars and practitioners, there seems to be a new tendency leaning towards companies adopting some of the principles of the Stewardship paradigm as shown by Anderson et al. (2007). The researchers undertook a survey including 658 directors from Australia, Canada, New Zealand and the United States. They conclude that boards are currently leaning towards a strategic partnership with company executives. The authors state that:

"*While most research has focused on agency concepts of the board as monitors of management, our research suggests that the board is evolving towards a more collaborative role with management, consistent with stewardship theory. Our findings also suggest that directors are seeking a balance between collaboration and their role*

as monitors of management, rejecting the notion of the board as primarily a monitoring body".

As regards effectiveness in performance by the type of board proposed by the Stewardship theory, some studies have focused on the question of the duality of the CEO being also chairman of the board, with mixed results. Donaldson and Davis (1991) and Coles et al. (2001) found that boards headed by the company's CEO achieved higher returns for shareholders. On the contrary, Rechner and Dalton (1991), through a study over a 6 year period, proved that companies with a separate power structure (CEO different from chairman of the board) consistently outperformed companies relying upon CEO duality.

There are others who have studied the subject finding no relationship between performance of the firm and joint or separate power structure. Daily and Dalton (1993) researched the importance on company performance of boards headed by the CEO and with a lesser number of independent directors. These companies had a higher tendency to end up in bankruptcy.

Theoretical and empirical research shows no definite conclusions regarding the performance and evaluation of boards functioning under the stewardship principles.

Resource Dependence Theory. Resource Dependence theory (RDT) was developed by Zahra and Pearce and Pfeffer & Salancik, 1978, Zahra & Pearce II, 1989, Boyd, 1990. It has its origins in economics, sociology and organizational theory. Companies are seen as an amalgam of tangible and intangible assets and capabilities. In essence, the resource dependence perspective sees boards as "boundary spanners", a means for executives to go beyond the borders of their own company and obtain important resources in the external environment in which companies operate.

Managing external influences is the crucial role of the board and its goal, to expand the company's influence and leverage on external resources. Resources are "*anything that could be thought of as a strength or weakness of a given firm*" (Hillman & Dalziel, 2003). Boards reinforce top management's capacity and experience, participating in strategy creation by proposing their own initiatives or alternative options to those of the firm managers.

This approach emphasizes companies' dependence on their environment and the strategies they can use to manage these dependences. Board members are selected for their background and experience, contacts and skills in "boundary spanning". Uncertainty caused by external environmental factors and dependence on outside organizations can be minimized. The advantages that board directors can bring include: advice, access to information, preferential access to resources and legitimacy. They can also contribute legal expertise, political lobbying power and access to financial resources (Bezemer, Maassen, Van den Bosch, & Volberda, 2007).

According to Davis and Cobb (2009), *"There are three core ideas of the theory: (1) social context matters; (2) organizations have strategies to enhance their autonomy and pursue interests; and (3) power (not just rationality or efficiency) is important for understanding internal and external actions of organizations. The emphasis on power, and a careful articulation of the explicit repertoires of tactics available to organizations, is a hallmark of resource dependence theory that distinguishes it from other approaches, such as transaction cost economics".*

RDT saw its peak during the 1980s but since then has received much less attention. Recently, though, there has been a kind of revival as shown by various studies such as Casciaro and Piskorski, 2005, Westphal et al., 2006, Gulati & Sytch, 2007, Katila et al., 2008, Ozcan & Eisenhardt, 2009.

Davis and Cobb (2009) explain the renewed interest in the theory by the fact that the current global environment has much in common with that dominant at the time Jeffrey Pfeffer and Gerald R. Salancik wrote their classic work in 1978. Economic crisis, uncertainty, extended skepticism and questioning of the political class, social discontent… all contribute to make "*issues of power and dependency more salient*". They go on to suggest that future work should address the issues of "*updating the sources of power and dependence, and cataloging the new set of available tactics for managing dependence".* RDT may continue to be a useful way of understanding the behavior of companies and their boards, if it adds new perspectives and takes into account the new environment that has essentially changed through *"the ubiquity of information and communication technologies (ICTs), the rise of finance, and globalization in trade".*

Effectiveness of boards within the RDT view should be assessed in terms of the

contributions made by directors in managing the dependence relationships of companies with the outside world. In this sense, RDT considers an advantage that directors serve in multiple boards, since it gives them important opportunities to obtain information and expand networking.

However, RDT does not emphasize effectiveness or ways to measure board performance. As it is usually the case with the various theoretical approaches, their goal is to explain, to understand and point out the needs that a firm may satisfy through its board, but not to evaluate board performance.

Stakeholder Theory. Stakeholder theory was originally developed by Ian Mitroff in 1983. However, R. Edward Freeman, through his seminal book *Strategic Management: A Stakeholder Approach* (1984), is considered the founder of the Stakeholder theory.

As we have seen, within the theory underlying the practice of most corporations −Agency theory− the aim has always been to maximize value for shareholders. Stakeholder theory goes beyond this paradigm to encompass the interest of "stakeholders". According to Freeman (2004), stakeholders are "*those groups who are vital to the survival and success of the corporation*". They include, among others, customers, employees, suppliers, distributors, communities, financiers, government bodies, trade unions.

The role of the board is to ensure value creation for the company which in its turn depends on the commitment of key stakeholders. The board has first to identify the key stakeholders, then understand and represent their views. Since the interests of the various stakeholders may conflict with those of shareholders, the board has to manage a series of complex tradeoffs.

Perhaps the most visible influence of the Stakeholder theory is seen on the Corporate Social Responsibility (CSR) concept. Through CSR, companies add the social and environmental dimension to their goals. They voluntarily commit to include in their strategy social and environmental concerns that, if respected, will benefit the communities and the environment of the locations and countries in which they operate.

CSR is another way of taking into account the interests of stakeholders. Employees prefer to work in socially responsible companies, in the same way that increasingly

more and more consumers prefer to buy from firms that do not use slave work (be it from children or adults), that respect and take care of the environment, use recycled materials, and in any other way show commitment to others and not exclusively to their shareholders. Closely related to CSR is the increasing concern for sustainable development and over our legacy to future generations.

The theory has been criticized. Its detractors point out that it is not simply based on economics but includes philosophical, sociological and ethical aspects. Others indicate that Freeman's definition of stakeholder is too wide and therefore impractical. Jensen (2001) states that:

> *"Because the advocates of stakeholder theory refuse to specify how to make the necessary tradeoffs among these competing interests they leave managers with a theory that makes it impossible for them to make purposeful decisions. With no way to keep score, stakeholder theory makes managers unaccountable for their actions. It seems clear that such a theory can be attractive to the self-interest of managers and directors".*

Nevertheless, Jensen goes on to refine the Stakeholder theory and offers a view regarding how to make firm's managers and board directors accountable for their actions. Creating value in itself does not motivate employees and other stakeholders. Market value of the company becomes the only means of evaluating the performance and effectiveness of managers and boards. The measure has to be complemented by "*a corporate vision, strategy and tactics that unite participants in the organization in its struggle for dominance in its competitive arena*".

Companies cannot maximize their value without considering the interests of the various stakeholders. Jensen's solution is what he calls "*enlightened value maximization*" or "enlightened stakeholder theory" which uses "*maximization of the long run value of the firm as the criterion for making the requisite tradeoffs among its stakeholders*".

Jensen also discusses the ineffectiveness of Balanced Score Cards for managers. On the other hand, there are proponents of the use of Balanced Score Cards for boards of directors, such as Kaplan and Nagel (2004). The Board Score Card proposed by the authors "*introduces a stakeholder perspective, reflecting the board's responsibilities to investors, regulators, and communities"* and provides the following advantages:

- *"Defines the strategic contributions of the Board*
- *Provides a tool to manage the composition and performance of the Board and its committees*
- *Clarifies the strategic information required by the Board."*

Additionally, the Board Balanced Score Card sets specific "*internal process objectives of the board"* and takes care of the accountability of board committees.

Although perhaps in an indirect manner, it can be concluded that the Stakeholder point of view is the closest to establishing objectives to evaluate board performance.

Theoretical lack of attention to evaluations. Having briefly revised the key theories, it could be argued that they significantly contribute to explain and make us understand the various issues related to board composition, its structure, processes and ways of functioning. However, the fact that they focus on one aspect to the exclusion of the rest limits their practical application. Some authors such as Minichilli (2007), Rasmussen (2015), Huse and Gabrielsson (2012) and Huse (2005) have endeavored to combine two or more of the theories to achieve a more comprehensive approach. Their pluralistic perspective analyses expected board performance regarding value creation and accountability. The aim of such combinations or complementary views is to make board's work more efficient and improve its performance.

However, little attention has been devoted to the effective measurement of results achieved by boards. Yes, they have to comply with current regulations, they determine executive compensation, contract auditor firms and take care of a myriad of other tasks. But theorists, and indeed practitioners too, so far have not devoted much work to the setting of specific quantitative and qualitative goals that would enable companies to evaluate the performance and contribution of their boards of directors.

Given the high pressure from public opinion, regulators and other stakeholders on board responsibility and accountability –as it has been already noted− it is highly surprising that there is no general framework or methodology being currently adopted by firms, whose boards should be held accountable for the economic, social and ethical performance of the companies they serve.

Board Evaluations: A powerful Tool

Despite the many views on how boards may affect corporate performance, the most predominant approach is the board as a mechanism to monitor management and control agency costs, as explained above.

However, this is a limited view, since it ignores other critical components of corporate governance, such as board composition and structure, group dynamics, types of relationships between board members, the processes used or the quality of the information received. External and internal environment influences, such as informal relationships, ethics and distribution of power are also omitted (Kiel and Nicholson, 2004).

There is a raising awareness of the need to conceptualize how boards add value to organizations (Daily, Dalton, & Cannella, 2003). In this sense, the board is conceived as a general model and a social phenomenon, as a dynamic and open system. The boards and corporate outcomes are interrelated, they conform an open system influenced by internal and external environments (Kiel and Nicholson, 2005)

Evaluations are also considered as useful tool to better understand the roles and responsibilities of directors, to improve relationships between board and management, to promote a healthy balance of power and to study the strengths and weaknesses of board performance (Conger et al., 1998; Kiel and Nicholson, 2005). Moreover, the implementation of formal and regular board appraisals may serve to strengthen external accountability and motivate boards to demonstrate trust, reliability and transparency, thus enhancing their reputation (Daily and Dalton, 2003). Others highlight the fact that board evaluation is "an effective team-building, ethics-shaping activity (Kiel and Beck, (2006). They also summarize the potential advantages of conducting board evaluations as presented in the following table.

Potential benefits of board evaluation

BENEFITS	TO ORGANIZATION	TO BOARD	TO INDIVIDUAL DIRECTORS
Leadership	● Sets the performance tone ● Role model for CEO and senior management team	● An effective chairperson utilizing a board evaluation the demonstrates leadership to rest of the board ● Demonstrates long-term focus of the board. ● Leadership behaviors agreed and encouraged.	● Demonstrates commitment to improvement at individual level.
Role clarity	● Enables clear distinction between the roles of the CEO, management and the board. ● Enables appropriate delegation principles.	● Clarifies director and committee roles. ● Sets a board norm for roles	● Clarifies duties of individual directors. ● Clarifies expectations.
Teamwork	● Builds board/CEO/management relationships.	● Builds trust between board members. ● Encourages active participation. ● Develops commitment and sense of ownership.	● Encourages individual director investment. ● Develops commitment and sense of ownership. ● Clarifies expectations.
Accountability	● Improves stakeholder relationship (e.g. investors, financial markets). ● Improved corporate government standards. ● Clarifies delegations.	● Focuses board attention on duties to stakeholders. ● Ensures boards is appropriately monitoring organization.	● Ensures directors understand their legal duties and responsibilities. ● Sets performance expectations for individual members.
Decision-making	● Clarifying strategic focus and corporate goals. ● Improves organizational decision making	● Clarifying strategic focus. ● Aids in the identification of skill gaps on the board. ● Improves the board's decision making ability.	● Identifies areas where directors' skills need development. ● Identifies area where the director's skills can be better utilized.
Communication	● Improves stakeholder relationships. ● Improves board-management relationships.	● Improves board-management relationships. ● Builds trust between board members.	● Builds personal relationships between individual directors.
Board operations	● Ensures an appropriate top-level policy framework exists to guide the organization.	● More efficient meetings. ● Better time management.	● Saves directors' time. ● Increases effectiveness of individual contributors.

Source: Geoffrey Kiel and James Beck. Seven steps to effective board and director evaluations. *Company Secretary*. November 2006.

There are multiple perspectives among scholars, but common themes emerge when they address board evaluation. They all coincide in:

- The need to first clarify the purpose or goal of the evaluation since it will determine the whole process.
- The need to specify the addressee(s). Who will be the recipients of the evaluation results? Will it be an internal or an external audience?
- The need to decide who evaluates. There is a choice between internally conducted evaluations or hiring external consultants or advisers to perform the evaluation.
- The need to determine the evaluation content. Matters often mentioned include: value creation, control and compliance, work of committees, strategic role of directors, board structure, processes and functioning, board dynamics or directors' individual performance.

In the remaining of this section I review in chronological order what I consider the most interesting perspectives of scholars who have studied the subject of board evaluation.

Kiel and Nicholson–The seven questions (2005). They propose a framework for a successful board and individual director evaluation. It is based on seven key questions and boards should reach an agreement on their answers. The questions include:

- What are the objectives?
- Who will be evaluated?
- What will be evaluated?
- Who will be asked?
- What techniques will be used?
- Who will do the evaluation?
- What will they do with the results/outcomes?

Before starting an evaluation, there must be an acknowledgement of the goals the board

wants to achieve. A set of specific goals has to be defined (issues the board wishes to evaluate), the scope of the review must be determined (depending on the depth of the problem and the availability of resources −financial, human and time). Motivation for the evaluation process falls under two categories: a) corporate leadership (commitment to review and improve performance) or b) problem resolution (inefficient governance, problems in board dynamics, insufficient skills or competences…).

Regarding the "who", boards have three possibilities: to evaluate the board as a whole, the individual directors and the key governance personnel, mainly the CEO and board secretary. Regular evaluation of the whole board can help directors to develop a common understanding of their governance role and responsibilities. However, it may give a limited understanding of potential performance problems. Individual evaluation, in particular, provides the board with an opportunity to probe specific issues in depth. They allow directors to review their personal contributions and actions, identifying their strengths and weaknesses.

As to what will be evaluated, Kiel and Nicholson contend that evaluation goals should be specified in terms of defined topics. The aim is to detect potential problems, identify their root cause and evaluate the functionality of specific governance solutions, if possible. Furthermore, if the organization's objective is to tackle governance issues or to improve board performance, this implies the assessment of many variables. Commonly, most governance concerns are the result of the interplay between several factors −individual skills, experience and motivations, relationships between the board and management… (Kiel and Nicholson, 2003).

Regarding the issue of who will be asked, evaluations are commonly held internally by the board, the CEO, senior managers or other personnel and employees of the company. Internal evaluations aim at leveraging the board members' knowledge and self-evaluation capabilities. If the goal of a given evaluation is to internally assess contingent factors, such as productivity, member skills, intra-board relationships or communication effectiveness, for example, the evaluation will be an internal process with board members being the primary source of information.

In other scenarios, however, board evaluation may address external factors, such as stakeholder relationships, corporate branding or management reputation. In those externally contingent evaluations, the relevant information can be gathered from the

stakeholders themselves. Depending on the nature of the business, these may be owners, financial analysts, customers or suppliers critical to the organization's success.

Susan Shultz–Emphasis on questionnaires (2009). Ms. Shultz contends that a comprehensive valid evaluation provides a platform for designing an action plan to continuously improve the effectiveness of the board. She highlights the fact that there are two extremes at the evaluation spectrum: the compliance "check the box" mindset at one end and the commitment to address improvement areas to reinforce good practice, at the other. Through meaningful evaluation, a strategic board goes beyond compliance. She outlines the key attributes of a correct evaluation.

To start with, questions and results should be independent from the company and its board. It should include benchmarking against good practice and peers. The evaluation system should be clear and easy to use and implement, report strengths and weaknesses, and provide accurate information.

Additionally, an evaluation should follow a professional methodology asking the proper questions in an adequate way. It must be regularly performed and questions answered anonymously. A third party can assure these conditions, safeguarding the privacy and security of the assessment data. The questionnaires should be adjustable so they can be readily modified to add any key issues required by the company.

Furthermore, the evaluation must have a "board-centric" approach. That is to say that the board has exclusive control of the process and its outcomes and determines the conditions of the evaluation: who participates, how the results are shared and used, etc. Quantitative as well as qualitative data should be appraised. Quantitative questions should ask about the frequency of meetings among key officers, advisors, and auditors. Qualitative questions may assess the amount of time spent by boards in discussing strategy and the level of engagement of the board members in those discussions. Level of participation and activeness, quality of communication with shareholders, awareness of the key financial metrics that drive the company should also be part of the evaluation.

Additionally, there must be separate evaluations for each committee and individual director. And there should be inclusiveness in the respondents at the discretion of the board, including all board members together with others working with the board such as

non-director officers, outside counsel, auditors, consultants and perhaps shareholders.

A final boardroom discussion is necessary to prompt the board to take action in the most important areas of corporate governance. The board decides whether to and how to address the issues that have arisen and which are the corrective measures to be implemented in order to improve their performance.

Huse and Gabrielsson–Report, recruitment, development (2012).

The authors outline the features of various possible board evaluation systems. Designs will vary according to the agent chosen to evaluate the board, the addressee and other stakeholders for whom the board is evaluated, the evaluation content and the modalities of evaluations a board adopts. They describe three main types of board evaluations that are used and recommended in most codes of best corporate governance practices:

- *Report evaluations* that take different groups of stakeholders as a starting point for the evaluation, in order to foster self-awareness and a sense of accountability regarding the board's behavior and actions.
- *Recruitment evaluations* which focus on balancing experienced and competent with new, recently nominated board members.
- *Development evaluations* which aim at enabling board members to focus on improving areas of corporate performance that score highest when it comes to creating incremental value.

Regarding the addressee, or to whom the evaluation is targeted, boards can address their evaluation to internal and external stakeholders with the purpose of enhancing their reputation or as a result of stakeholders´ management. Shareholders and investors groups may evaluate the board in relation to code compliance requirements and address the evaluation to the board itself. Other addressees could be internal or external board committees, researchers or academics, other regulators, etc.

Huse & Gabrielsson agree with Minichilli et al., (2007) that the content of a comprehensive evaluation depends on the purpose. However, there are several steps to be followed and different aspect to be analyzed.

First, an evaluation of stakeholders regarding their fields of action, decisions and influence; secondly, performance of boards tasks, accountability and value creation; Thirdly, the board composition and nominating system as well as individual members' education and professional background and capabilities. Another step is the assessment of board team culture and board-CEO relationship. Board leadership and operational aspects are also of interest. The latter include meeting agendas, length and frequency of meetings, submission and sanction of minutes. The analysis should also include descriptions of the CEO's work, instructions for board governance and development, as well as concrete procedures for new board members when they join. Board evaluations should be followed up and compared to previously conducted evaluations.

Evaluations may be conducted by boards themselves or their committees such as the nomination, remuneration or audit committees. They may also be performed by consultants with different backgrounds or fields of expertise such as law, accounting, finance, management or even boardroom specialists. Consultants may conduct the evaluation on behalf of the boards, committees or other external agents.

There are diverse methods or modalities of board evaluations, more or less formal or informal. The authors recommend performing evaluations on a regular basis, twice a year or even after every meeting. They can be held in open discussions in board meetings. Self-evaluations schemes or standardized schemes and questionnaires may be used. Other methods include observation and direct monitoring, official reports to institutional authorities, or analyzing and acting upon meeting notes, shared documents and summaries of board activities. Comparative or benchmark analyses in relation to boards of similar firms is another possible approach as is interviewing board members, company's managers, shareholders and other stakeholders. A chosen evaluator may also attend board meetings as an observer.

Lastly, the authors recognize two main purposes to conduct a comprehensive board evaluation. One is internal and related to the extended recognition among board members about the benefits of formal evaluations in fostering value creation and effective performance. The second purpose is external. It aims at satisfying external requirements such as those stipulated by Codes of Governance and/or obtaining potential market rewards and prestige.

The Deloitte Perspective–Strategy, control and support. According to the Deloitte report (2014) on the subject, boards perform three main roles:

- Providing strategic direction of the company.
- Management control and monitoring.
- Providing support and advice.

Board evaluations commonly examine these roles and assess how effectively they are fulfilled. The Deloitte report contends that the effectiveness of the board depends on a variety of factors and the evaluation is essentially an assessment on how the board has performed on parameters such as:

- Board structure (composition, constitution, diversity, procedures, etc.),
- Functioning dynamics (annual calendar, information availability, communication with CEO, quality of participation, etc.),
- Business strategy governance (board´s role in company strategy),
- Financial reporting processes such as internal audits and internal controls (integrity and robustness of financial and other controls).
- Monitoring role (monitoring of policies and strategy implementation).
- Supporting and advisory role.
- Chairperson's role.

Janicke Rasmussen– Performance, conformance to content and context (2015). According to the Norwegian Professor, board evaluations contribute to assess actual performance according to a set of standards and they are used to implement corrective measures in case of deviation from the expected performance. The author has studied the effect of implementing board evaluation processes on board effectiveness

A unitary firm external perspective takes a shareholder approach, where boards are meant to create value and be at the service of shareholders' interests. Whereas, the balancing external perspective emphasizes value creation for stakeholders, boards are accountable for a broad variety of stakeholders' interests.

The unitary firm internal perspective emphasizes value creation for the management. Under this point of view, boards of directors primarily serve managerial interests and the organization's corporate goals and objectives. However, the board has no real power and at most serves as a counselor or cabinet for the CEO. While a balancing internal perspective focuses on what is best for the firm and creating value throughout the whole value chain.

By applying the question "*value creation for whom*?" Rasmussen defined three levels of accountability to measure board effectiveness: board performance, conformance to content and conformance to context.

Board performance is the highest level and uses balancing and firm internal perspectives on boards and value creation. Boards should do what is best for the company balancing the expectations of all stakeholders. When the purpose and expectations take into consideration all relevant stakeholders, this suggests that the evaluation is performed to appraise board performance.

Conformance to content is a lower level of board effectiveness and uses a unitary and company external perspective on value creation. It deals with value creation for external stakeholders/owners identified in external codes regarding boards' work, for instance the Norwegian Code. In another words, if the evaluation has the purpose or expectation to satisfy external requirements, this means it is performed to conform to content.

Conformance to context is the lowest level and uses a unitary and firm internal perspective on value creation. It deals with value creation for boards.

She defines the basic elements that should be taken into consideration when designing the board evaluation:

- Deciding on a clear purpose.
- Deciding on the object(s) of the board evaluation.
- The content of the evaluation.
- The evaluator.
- The modality to be used.
- The follow up procedure.

To begin with, the purpose is the crucial factor (Conger et al. 1998; Conger 2002; Huse and Gabrielsson 2012). Deciding on the purpose allows directors to identify relevant expectations and to develop the process to fulfill them.

Based on Minichilli et al. (2007) Rasmussen explains some indicators that enable board measurements to be identified. If the evaluation has no purpose to achieve or expectation to fulfill, there is no possibility to compare real with expected performance and therefore the evaluation is conducted to conform the context.

Regarding the evaluator, if the evaluation has a clear purpose, it will probably use an external evaluator to achieve objectivity and therefore the evaluation will be carried out to conform to the content or the context. On the other hand, if it is internally conducted and with no clear purpose, it means the evaluations is carried out to conform to context.

Methods to assess board performance (internal approach) may include surveys, interviews, documents analysis, and participant observation.

On the contrary, in an external approach, evaluations are conducted by external agents and Rasmussen agrees with literature (Minichilli et al. 2007; Kiel and Nicholson 2005; Shultz 2009) on surveys being the most common and convenient method. Surveys offer the advantage of enabling year to year comparisons, benchmarking and comparisons against practice codes.

Finally, the author has found evidence in literature about the importance of follow-up procedures used to design improvement action plans. However, authors generally avoid specifying the content and who should be in charge of the follow up. She found that follow-up procedures are identified in evaluations that assess board performance or conformance to content tackling the deviation between expected and actual performance. However, she could not find evidence of any follow-up procedures in evaluations performed to conform to context.

Cohn and Kess–Time, information, dynamics (2016). These authors contend that in order to conduct an effective evaluation process, there are specific key topics to be addressed taking into account the evaluation objective(s). They also formulate the questions that should be used to assess each of these issues in the evaluation process. These include questions related to:

***The efficient use of time*:** in order to assess board effectiveness, evaluations should examine whether or not the board allocates its time appropriately. This measure reveals whether or not the board is focused on the relevant issues. Other aspect related to time is preparation time allowed directors before meetings.

The quality and quantity of information. The aim is to ensure that directors get the right quantity and quality of information and have sufficient time to evaluate it. The amount of information received is a crucial factor for the effectiveness of boards. The tendency is probably to hand too much information to directors. Excessive information entails the risk of directors not being able to devote enough time to the issues at hand. In this respect, executive summaries are useful.

Board culture and dynamics. In assessing the board's effectiveness, evaluations should address the quality of the directors' mutual relationships because this affects their ability to work productively as a unit. Group dynamics affect performance. Diverse or even opposed views should be part of board dynamics as well as "respectful disagreement".

Board composition, leadership structure and role of independent directors. There must be the right balance of skills, experience, independence and knowledge of the company within boards, if they are to be able to skillfully monitor company's management and tackle potential problems. Furthermore, leadership structure must be addressed periodically to assess its efficiency and to check that independent directors are able to fulfill their roles without obstacles. Diversity is also to be taken into account. The sharing of different perspectives usually generates positive effects.

Control and Compliance. Boards should create and promote an appropriate culture of control and compliance within the company. Evaluations should consider such aspects as the control environment of the company or the processes used to identify and evaluate risk.

Board oversight. Board evaluations should determine whether the board is effective in overseeing management, supporting it and advising it.

Committee effectiveness. The work of the three usual committees (audit committee, compensation committee and nomination committee) within boards of directors should

be assessed too. Committees should efficiently interact with the full board and inform on the results of their work. Other relevant questions posed by Cohn and Kess include: "*Is the committee structure effective? What is working and what could be improved? Should the company have a risk committee separate from the audit committee?*"

Additional topics that may be incorporated in an evaluation include, for instance, the CEO succession plan or issues concerning promotion and development within the company.

To conclude this section, the following table presents a brief summary of the key concepts expounded by each researcher or author(s).

SUMMARY OF WORKS STUDIED

AUTHORS	KEY THEMES
Kiev and Nicholson (2005)	The seven questions: ● What objectives? ● Who will be evaluated? ● What will be evaluated? ● Who will be asked? ● What techniques will be used? ● Who will do it? ● What will be done with the results
Susan F. Shultz (2009)	● Strategic boards should go beyond compliance. ● Evaluations should result in action plan to continuously improve board performance. ● Better if conducted by independent third parties. ● Board has exclusive control of the process. ● Questionnaires should include quantitative and qualitative questions.
Huse and Gabrielson (2012)	● Report evaluations taking different groups of stakeholders as the starting point. ● Recruitment evaluations to balance experienced directors and new additions.. ● Development evaluations which focus on improvement areas that have the most incremental value.
Deloitte report (2014)	● Boards perform 3 roles: strategic, monitoring and control, and support and advice. ● Parameters evaluated should include: structure; functioning dynamics; business strategy

	governance; financial reporting process; monitoring policies and strategy implementation; supporting and advisory function; and chairperson's role.
Janicke Rasmussen (2015)	● Top question is value creating for whom? ● 3 levels of accountability: o Performance: to appraise boar performance o Conformance to content: to satisfy external requirements. o Conformance to context: to assess value creation for the board.
Cohn and Kess (2016)	Key parameters to be evaluated include: ● Efficient use of time. ● Quantity and quality of information. ● Board culture and dynamics. ● Board composition, leadership structure and role of independent directors. ● Control and compliance. ● Board oversight of management ● Committees' effectiveness.

In summary, this chapter has reviewed the various evaluation theories and various contributions to the subject made by the literature, starting with a discussion of the concept of evaluation as it is most commonly performed today, with relatively little impact. Then each of the main board theories (Agency theory, Stewardship, Resource Dependence Theory and Stakeholder Theory) and how they deal with the subject of board evaluations was reviewed concluding that relatively little attention is paid by these theories to board evaluations and its potential benefits. None of them considers the possibility of setting company specific objectives for boards to achieve and regularly – annually at least– measuring board performance against those objectives.

The next section of the chapter reviewed contributions to the subject by authors such as Kiel and Nicholson, Susan Schulz, Huse and Gabrielsson, Janicke Rasmussen, and Cohn and Kess. Analysis of the literature mentioned above leads to the conclusion that theories and theorists focus more, if at all, on the objectives and purpose of the evaluation process itself rather than on the objectives and purpose of the board, although the latter seems more reasonable as the board is the subject of the evaluation, not the process itself.

Furthermore, the different perspectives offered by the various theories support the conclusion that the purpose and objectives of each board in each company may be significantly different, reinforcing the importance of making each specific board, in its company specific circumstances, the subject of the evaluation process.

Having said this, it also seems reasonable to conclude that certain process issues may indeed be the same regardless of company specific board objectives, rendering them subject to more standard evaluation and to benchmarking across companies.

The following chapter reviews current evaluation practices through the evidence provided by the reports of leading consulting firms as well as reviewing the practices of some individual companies, some admired for their governance practices, others less so.

IV. Current Evaluation Practices

This chapter reviews evaluation practices. First it describes the results obtained by surveys and reports produced by specialized entities and consulting firms, it also includes the results of the survey conducted by the author´s board advisory firm (Advisory Board Architects - ABA).

Then it goes on to study the practices of a few chosen examples of the international business world. A third section is devoted to the particular case of Spain, the evolution of good governance principles and practices, the regulatory development and the real practices implemented by such companies as Banco Santander and Iberdrola, for example.

Among the professional surveys and reports, the author has chosen the ones from such prestigious firms as PricewaterHouseCoopers, Korn Ferry, Spencer Stuart or McKinsey & Co. Most of them issued during 2016.

To study the practice of real companies, two criteria have been followed. The first is how the companies rank in global corporate governance. Microsoft Corporation and British American Tobacco have been chosen since they are considered models in this sense. The second criterion followed is a geographic one, seeking to add the Asian perspective to the European and American examples analyzed. In the case of Spain, the work focuses on Ibex 35 -the benchmark stock market index of the Madrid Stock Exchange- companies.

A final addition to the chapter is a very detailed real board evaluation questionnaire designed and used in Australia.

Reports and surveys about current practices

Leading consulting and advisory firms such as Deloitte, PwC, McKinsey and Company, Korn Ferry and others develop surveys that address different areas of corporate governance. They review, among other topics, board composition, board culture and dynamics, board's strategy implementation, board workload, board training, board members’ expertise and capabilities or board evaluations. The outcomes of this research work shed light on the current functioning of boards and the effectiveness of its

performance against set standards.

In parallel, listed companies worldwide publish annual corporate reports in compliance with key governance principles and current regulations. Some examples are presented here showing how they report on corporate performance and practices.

> *"In a study of 187 boards we undertook with The Miles Group, a consulting and advisory firm, we found that most board evaluations fail to identify and correct poor performance among individual members [...]. All publicly traded companies are required to conduct an annual evaluation. The evaluation process can be greatly improved by treating the board as a high-performing group of individuals and evaluating its leadership, management, and group dynamic".*

(Source: Larcker, D., Griffin, T., Tayan, B. and Miles, S. How Boards Should Evaluate their Own Performance, Harvard Business Review, March 01, 2017)

All of the reports shed light on the current functioning of boards, their practices, achievements compared to previous surveys and improvement areas that still need to be worked on.

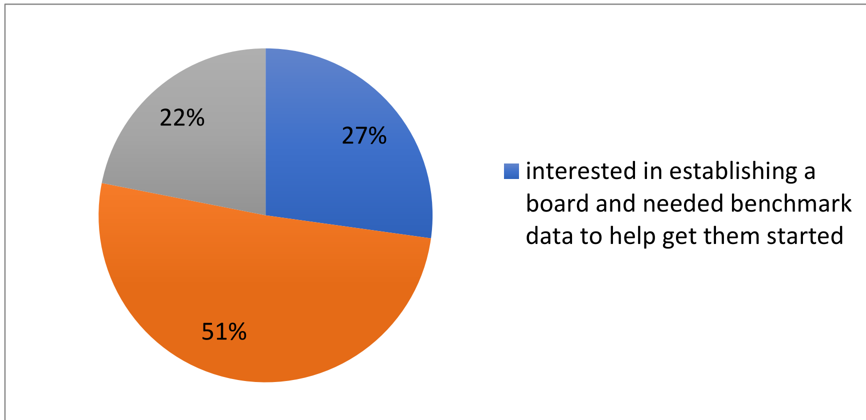
ABA Survey. Between the years 2014 and 2017, Advisory Board Architects (ABA) - the author's board advisory firm- conducted a survey of 397 companies from all over the world. The questionnaire for board directors comprised a variety of questions about whether the firms have or would like to have a board of directors, their features, frequency of evaluation, and future plans to evaluate.

The geographical location of the respondent companies included North America (US, Canada and Mexico) to Central, Southern, Eastern and Western Europe, as well as Central and South America, South and North Asia, South Africa and the Middle East.

Respondents belonged to small and medium sized companies (from 1-50 employees to 101-500 employees) and large corporations (over 10.000 employees).

When asked what best described their current role or situation, more than half of respondents answered they were a board member interested in board best practices (e.g., compensation structure, industry benchmarks, etc.).

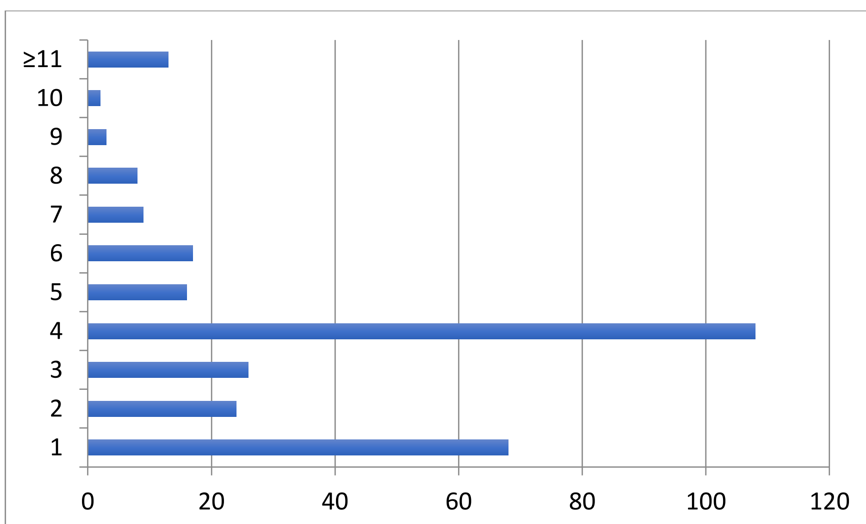
Most boards interested in best practices



When asked about the number of in-person annual board meetings they perform, almost two-thirds of respondents indicated between one and four board meetings as the standard practice. The most frequently occurring number of annual board meetings is four (27,2% of respondents), as shown in the following chart.

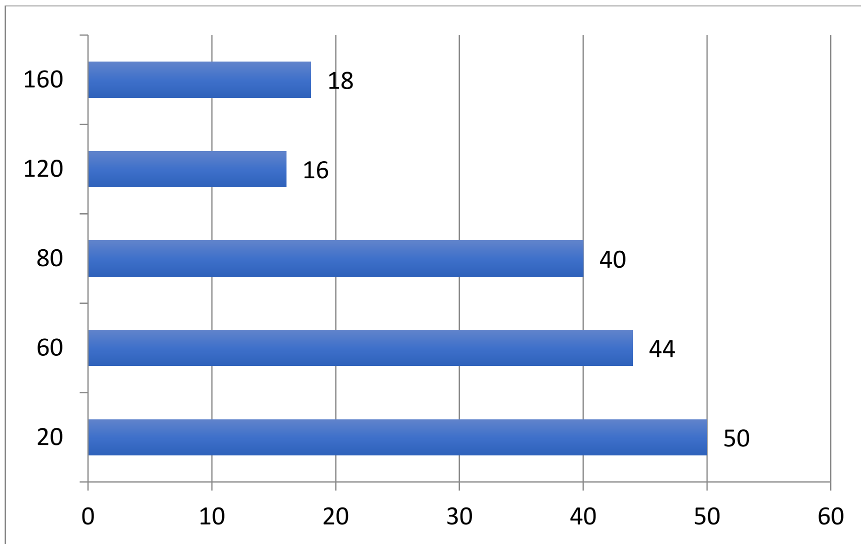
Most boards meet quarterly

Annual board meetings (y-axis) and number of respondents (x-axis)



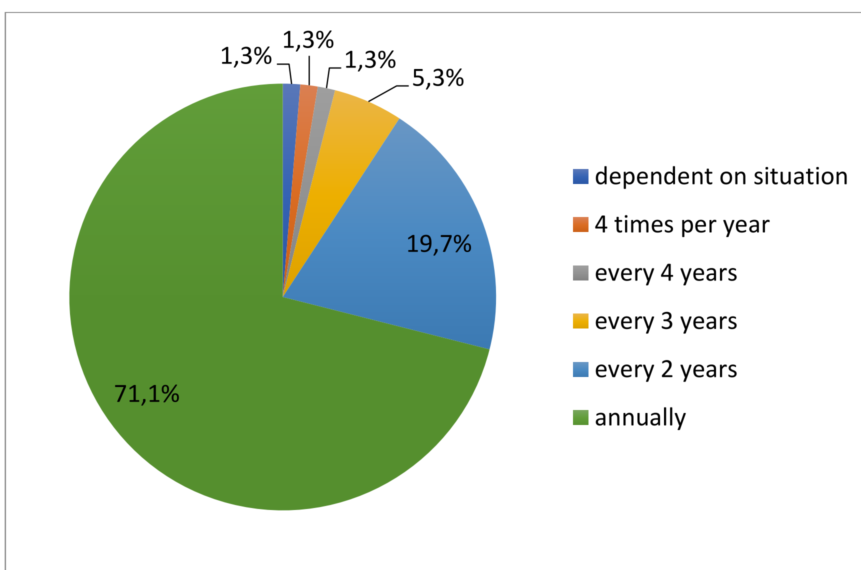
Regarding the amount of time spent on board work on average, on an annual basis, the highest number of respondents spent 20 hours or more, and a small percentage spent 160 or more, as shown below.

Most directors devote 20 hours/year to board work
hours (y-axis) and # of respondents (x-axis)



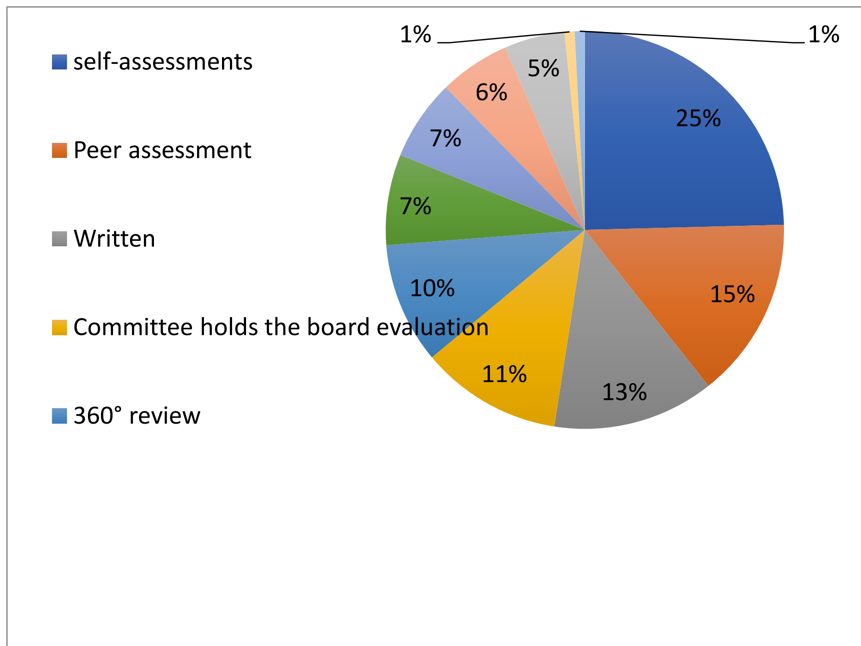
Regarding how often board evaluations are conducted, more than half of the respondents answered that they conduct annual evaluations, as shown in the following chart

Most boards evaluate annually



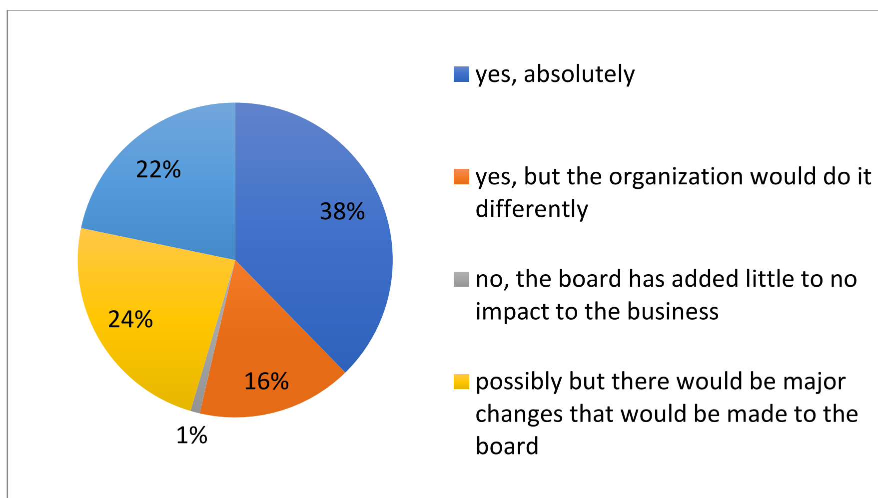
Regarding the type of evaluation, the highest number of respondents conduct self-assessments, a shown below.

Most boards evaluate through peer assessment



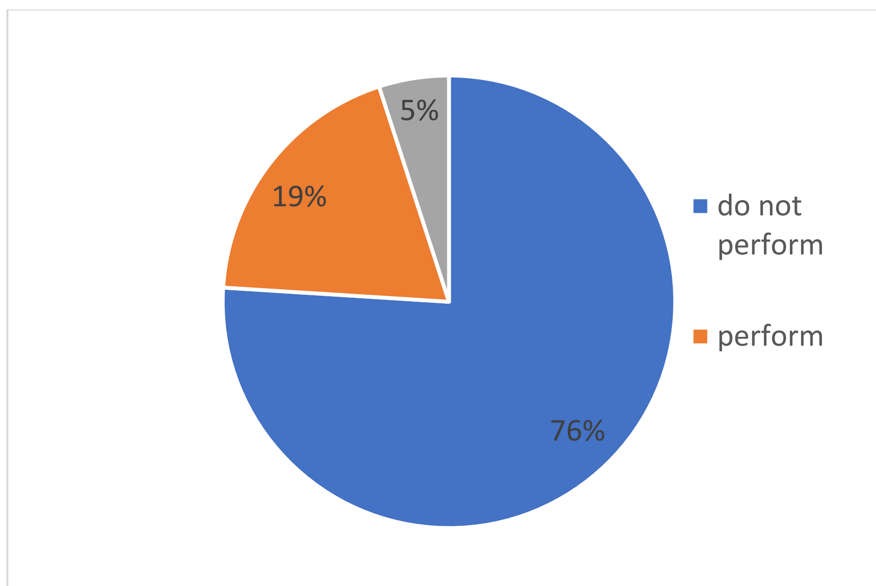
When asked if they think their organization would build their board in the same way again, the highest percentage of respondents answered that yes, they would establish it again in the same form, since it has been transformational for the growth of the organization.

Most companies would build their boards in the same way



Board evaluations usually not conducted. When asked if their board conducts any board evaluation of the board members, 75 answered they do and 300 answered they do not. That translates into only 19% of the respondents conducting some form of board evaluation, as reflected in the following chart.

Most boards do not perform evaluations



Perhaps this is the most remarkable finding of the ABA survey: the vast majority of companies do not conduct any board evaluation. Furthermore, from those who perform evaluations they do it once a year and by means of self-assessment. The second most common type of board evaluation is Peer assessment.

In summary, the survey results suggest that boards of directors are considered valuable and essentially required by the companies for their growth and development. Not all the companies, however, are entirely confident about the current composition and functioning of their boards.

From established practices to novel trends. The Deloitte (UK) Board Practices Report: Perspectives from the boardroom is published every year by the Society of Corporate Secretaries and Governance Professionals. The 2014 survey includes individuals from more than 1,200 public companies from numerous industries of varied sizes. The questions cover 16 board governance areas.

The findings revealed that the topics that concern boards the most are: implementation of strategy in conjunction with risk oversight, board composition and CEO succession, planning and cyber security.

More than half of the directors interviewed said they discuss strategy in every meeting. The majority is instructed on strategic alternatives and risks associated and they believe they receive enough information on the matter.

Power distribution still shows that almost 49% of large companies have combined CEO and chairman roles, whereas medium and small sized companies have chairman and CEO positions filled by two different individuals; 45% in the case of medium size companies and 50% in small size ones. The most common and increasing cause of board turnover is age limit and retirement. The most sought board skills and backgrounds are related to experience in a certain industry, experience at the executive or corporate level, and exposure to international and multilateral business relations.
Gender diversity is improving, 18% of respondents reported that they have increased the number of women in their boards. The percentage of women in boards has reached a 26%–50% in small and large companies.

A great percentage of surveyed companies said they educate their boards on big data and data analytics, particularly large companies. Boards are also being educated on topics such as director tenure policies, fiduciary duties, insider trading, and industry specific topics. Other trendy topics are ethics, company policies, and regulatory issues.

Improvements have also been achieved in the anticipated receipt of information prior to board meetings. Overall, 69% of companies send documentation 6 to 10 days in advance of board meetings. In large companies this represents a 10% improvement.

Regarding board evaluation practices, 45% of respondents report that board chairman or other directors conducted the evaluation and 25% stated that they did not have a formal board evaluation process. Other common procedures to evaluate directors are:

- "*Directors engage in self-evaluation for committees on which they serve and the board.*

- *Each committee and board does a self-evaluation, and the chairman meets with each director for peer evaluations and report results to lead independent director.*
- *The board and each committee evaluations forms, which are reviewed and reported on by the chairmen of those groups".*

In its conclusions, The Deloitte report highlights the fact that:

> *"As they head into 2015, the individuals surveyed said that the top three areas of board focus will be strategy, risk, and board composition, followed by succession planning and cyber security".*

10 Key findings. The PwC 2016 Annual Corporate Survey starts with the following initial paragraph: *Our 2016 Annual Corporate Directors Survey highlights continued changes in the boardroom. Companies are facing disruption from new technologies, geopolitical turmoil, cyber threats, increased regulation, and more vocal investors."* It then goes on to state that:

> *"The changing business landscape means boards have more to understand and more to oversee. So, they need to have the right people sitting at the table— diverse people with the best skills and expertise for the company—* […] *Some boards are tapping third parties for help, while others want to spend more time on strategic planning and IT strategy.*

The survey underlines a recent development: the increased influence of investors in boardrooms calling it "*the age of shareholder empowerment*". In fact, this is the overall theme underlying the report.

The 10 key findings bearing significant impact on corporate performance include the following:

Measurement of fellow board members**:** 35% of directors say someone on their board should be replaced; main reasons cited include the fact that directors are unprepared for meetings, they lack the right expertise or they are aging.

Board refreshment. In seeking new directors, board members traditionally follow fellow board member recommendations. However, there is mounting pressure from investors for increased board diversity. This has led to the use of other recruitment resources. Public databases have become another search source offering diverse candidates.

Differing views on the benefits of board composition diversity: 90% of board directors agreed on the importance of board diversity, however, male and female directors have differing views on the value of board diversity. Women had the strongest opinion on board diversity as an enhancer of company performance and board effectiveness. On the other hand, men are inclined towards a lower percentage of female −equal or less than one fifth or one half. Overall there is still a big gap to reach gender parity.

Where to find good, diverse board talent**:** In the pursuit of adding diversity to the board, there are different views on how to look for qualified potential director candidates. The most common option is to designate former CEOs; in this group, however, women and African-Americans are a minority. On the contrary, females agree to find qualified potential director candidates outside the organization and thus already 11% of interviewed directors are using public databases.

Concern about director workload. The great majority of interviewed directors answer that their workload is manageable, despite the fact that they spent an average of 248 hours on their board work in 2015.

Importance of CEO succession planning. Boards are increasingly interested in CEO succession. It is critical for them to have the optimal person at the helm of the company. CEOs are accountable for designing the company strategy, driving its execution and setting the "tone at the top". However, succession planning is not a priority in most directors' agendas, since they believe that CEOS are performing as expected. According to PwC's view, CEO performance is not a reason to not having in place a CEO succession plan for the future. All types of emergencies may unexpectedly demand a change or replacement of the CEO (personal issues, corporate failures or even scandals, sudden deaths).

Dialogue with Investors. There is an increased level of engagement between board directors, translated into openness in discussion topics such as board composition and

company strategy. However, there still is a percentage of directors (21%) who doubt the value of director-investor engagement; they consider it does not have a real impact on investor behavior.

Investors' expectations on board composition. Directors are receiving higher pressure from investors about board composition regarding diversity and tenure, given that "*having a board made up of the right people with the right experience and expertise is critical*". Consequently, boards are agreeing to changes in their composition.

Investor demands on company capital allocation decisions. Investors are demanding that companies count on a balanced capital allocation plan and that they oversee how resources are used. In this respect, 67% of directors stated that they are discussing the company's use of cash/resources with investors to ensure long term value creation.

Time, trust and challenge, and ambitious chair. The latest McKinsey Corporate Governance Report of 2016 (Toward a value-creating board) presents some insightful findings on corporate boards in contrast with its previous survey results from *2011.*

Amount of working time and commitment to strategy. Despite the fact that board commitment to strategy and time spent on it has raised substantially since 2011, board members still believe they need to devote more time to strategic issues. Survey results confirm that strategy is the subject they spend more time on in their board work: nine days per year. This is consistent with directors' belief that strategy is the highest value *contributor to the overall performance of the companies they serve.*

Value creation for the company. Most of the directors believe the impact of their boards on the company's value is high or very high. Paradoxically, however, some of the directors' view of their effectiveness and their own impact differs from their view of individual directors' performance.

Board's actions, dynamics and self-perception: To get a deeper understanding on how boards can be successful and create value, McKinsey analyzed three aspects of board performance: directors' assessments of the overall impact of their boards; effectiveness

at executing specific board tasks; and the way their boards operate. Their analysis resulted in three board profiles −ineffective, complacent, and striving.

Ineffective Boards. Directors report underperformance in their overall impact on long-term value creation and effectiveness at the 37 tasks they were asked about. Some of these tasks were simply not executed. For instance, a significant percentage claims their boards did not align with the executive team on how to manage company risk. On the positive side, 44% of respondents reported their boards are effective at securing and assessing performance of their top management team, and some of them considered themselves effective at reviewing the top-talent pipeline. Regarding boards operation, ineffective boards lack a culture of trust and respect in the boardroom, very few directors look for information on their own and just 1% say their board members received adequate induction training.

Complacent boards. Complacent boards have a more favorable view of their contribution to long-term value creation −44% rate their boards' overall impact as very high. However, the vast majority only reported effective execution in three out of 37 tasks they were asked about: "*ensuring that management reviews financial performance, setting the company's overall strategic framework and formally approving the management team's strategy.*" In general, they reported low health and talent management, for instance, only 9 percent of directors of complacent boards have an effective CEO succession planning. More than half of respondents reported a strong culture of trust and respect and about half say their boards spend enough time on team building. However, they referred to difficulties in assessing themselves; less than one in five reported their boards perform formal board evaluations or assess individual directors, or that their chairs ask other directors for input after meetings.

Striving boards. Half of the striving boards respondents report effective execution of 30 of the 37 tasks. They are particularly effective at strategy and performance management. They also demonstrate successful operation with an exceptional culture of trust and respect; meetings between board members and management team are constructive, reflecting good team work. Compared to complacent boards, they are more likely to conduct evaluations. However, only one third of these directors say their boards regularly evaluate themselves. Striving boards are the most committed to devote time to their work: they spend 41 days per year on board duties although they do not expect to

exceed this number. The average director spends 33 days on board work but, ideally, they would like to spend 5 more days.

The report concludes with three specific recommendations:

"Spend even more time". Time spent on work by boards has increased up to 50 days or more per year due to regulatory demands or simply because a good job demands more time.

"Balance trust with challenging discourse". Strong board dynamics with a culture of trust and respect are essential to ensure effective board performance. However, trust and respect should be combined with an environment where board members challenge each other as well as company top management, for instance, through performing regular evaluations or improving induction training.

"Appoint an ambitious chair". Another key factor to improve board dynamics and effectiveness is the presence of a chairperson able to exercise excellent leadership through running effective meetings, building a culture of trust and teamwork, implementing inductive training, providing relevant feedback and in general acting as facilitator of a more effective and value creating board.

Diagnose, report and establish improvement process. The Stanford Rock Center for Corporate Governance together with The Miles Group performed a 2016 nationwide survey of 187 board directors of USA public and private companies on Director Evaluation and Board Effectiveness. They obtained the following significant results:

- The vast majority (89%) of respondent directors believe their board has the skills and expertise needed to advise and oversee their companies. However, they report less effectiveness in bringing new talent and in refreshing board's capabilities. Only a third of respondents reported effective director´s succession planning for director turnover.
- A low level of directors' satisfaction with board evaluations demonstrates this area still needs to be improved. In fact, only 78 percent of directors expressed satisfaction (or great satisfaction) with the effectiveness of their evaluation

performance. As for individual member evaluations, just half of the interviewed companies assess individual directors and only a third believes the evaluation accurately evaluates the board member performance.

- Boards need to improve several critical areas:
    - Level of trust is not high enough. *Only two-thirds (68 percent) of board members say they have a very high level of trust in their fellow directors*.
    - More than half of the respondents believe there should be at least one director removed from their board because the person is not effective. Only 48% of board members would keep all of the current directors on their board.
    - Board members do not give honest and effective feedback to their fellow directors. Only 23% of board members rate their board peers feedback as very effective.
- There is also substantial room for improvement in boardroom dynamics. The study reveals that:
    - *"Directors do not invite the active participation of all members.*
    - *Directors allow personal or past experience to dominate their perspective.*
    - *Directors do not express their honest opinions in the presence of management.*
    - *Directors are too quick to come to consensus.*
    - *Directors do not understand the boundary between oversight and actively trying to manage the company.*
    - *Fellow board members derail the conversation by introducing issues that are off-topic"*.
- Female directors tend to have a more negative view on the effectiveness, skills and engagement of their peers, boardroom dynamics and the quality of board evaluation and feedback of their fellow directors.

  "*When asked to rate their boards on various attributes, female directors are much less likely to say their board is very effective in asking the right questions (36 percent give a rating of very effective versus 69 percent for male directors), challenging management (48 percent versus 68 percent), inviting the active*

participation of new board members (48 percent versus 76 percent), leveraging the skills of all board members (38 percent versus 63 percent), and tolerating dissent (32 percent versus 53 percent)."

The survey concludes with three specific recommendations to evaluate and diagnose board functioning and effectiveness.

Diagnose. To arrive at an accurate diagnostic, directors should provide their thoughts and opinions on issues such as board and committee effectiveness, composition, how to meet the strategic needs of the company, board structure and processes, information received, succession plans, relationship with top managers and board leadership.

Report the facts. A report should be written describing the information gathered and the conclusions obtained. It should also include an action plan on such topics as skills and experience that need to be added, feedback sessions on effectiveness and a coaching plan for each director.

Design and implement a process. Appoint a member of the board to manage this process and to ensure that recommendations are followed. It should also specify the procedure to remove underperforming directors.

The Canadian perspective. The 2016 Corporate Governance Best Practice Report by Korn Ferry (Hay Group) in collaboration with the Canadian Society of Corporate Secretaries is based on a survey including 81 respondents from organizations of various sizes, industries and structures. Among them, publicly traded companies (24%), privately owned (12%), not for profit (27%), crown corporations (a Canadian specific type of company) (11%), other (26%). Companies range in size from 0 to 500 employees and from 10,001 - 100,000; 53% of the sample is in the 0 to 500 employees range and only 12% of corporations are in the 10,001 - 100,000 employees range; 15% of the not for profit organizations belong to the category of 1,001 to 5,000 employees.

The survey deals with seven areas:

1. *Corporate governance overview*
2. *Corporate sustainability governance*

3. Pay for performance governance and design

4. Enterprise risk management oversight and governance

5. Engagement by a governance team

6. Boardroom diversity

7. Effective Board and Committee operations

In this work a closer look to *Effective Board and Committee operations* will be taken. The report states that over the past four years the number of corporations with a formal board evaluation policy has significantly increased. The most common form of evaluation is an individual peer evaluation survey led by the board secretary or other internal personnel.

Board education is taken seriously by a majority of the companies surveyed: "*Almost half of respondents report the majority of their directors attending an education program in the past year. The most common education topics include industry specific topics, risk oversight and organization policies*".

As for the increase in board performance evaluations, it has gone from 67% of the sample companies in 2014 to 80% in 2016. The formal policy for board performance evaluations usually includes written objectives, processes and reports. More specifically the report explains that:

> *From 2013 to 2015, there was an upward trend in Board performance evaluations conducted for the full Board as a whole, reaching a peak of 96% of organizations. In 2016, this number has decreased to 75% of organizations conducting the Board performance evaluation for the full Board as a whole and increased to one in four organizations conducting the Board performance evaluation on an individual basis.*

The proportion of publicly traded companies that conduct a full board evaluation is 62% compared to 80% of non-publicly traded corporations.

Methods used for evaluations include:

- Individual peer evaluation survey led by the board secretary or other internal

personnel: 31% of companies in 2015 compared to 36% in 2016.

- One on one with a designated board member: 33% in 2013, 22% in 2015 and 20% in 2016.
- Individual peer evaluation survey led by an external facilitator: 17% of sample companies in 2015 and 27% in 2016.

The S&P 500 boards. The 2016 Spencer Stuart Board Index. A Perspective on U.S. Boards report is based on a survey of the 500 companies included in the Standard and Poor's (S&P) index.

As general trends the Spencer Stuart report highlights the fact that investors' attention to board performance and governance is rapidly increasing. Large institutional investors, or "passive investors" as they are often called, are voicing their demands and expectations regarding issues such as board composition, disclosure and shareholder engagement. Long term investors, on their part, are increasingly concerned with good governance and corporate social responsibility.

Institutional investors are showing more and more concern about board composition and demanding that "*boards demonstrate that they are being thoughtful about who is sitting around the board table and that directors are contributing*". They are seeking more information about board renewal, board performance and evaluation practices.

And boards are listening. "*Directors want to ensure that their boards contribute at the highest level, aligning with shareholder interests and expectations*".

Large institutional investors are also demanding to know about board effectiveness and asking for performance evaluations. They seek "*greater transparency about how boards address their own performance and the suitability of individual directors — and whether they are using assessments as a catalyst for refreshing the board as new needs arise*".

According to the Spencer Stuart report, there is a trend advocating individual director assessment, to complement the overall board evaluation. The goal is "*not to grade directors but to provide constructive feedback that can improve performance*". But it will not happen soon. There has been an increase in the number of S&P corporations that assess the full board, its committees and individual directors every year. The

current percentage of companies that do so stands at 32% compared to only 29% in 2011.

As to who performs board evaluations, Spencer Stuart report states the following:

> *"In our survey of corporate secretaries, respondents said evaluations are most often conducted by a director, typically the chairman, lead director or a committee chair. A wide range of internal and external parties are also tapped to conduct board assessments, including in-house and external legal counsel, the corporate secretary and board consulting firms. Thirty-five percent use director self-assessments and 15% include peer reviews. According to proxies, a small number of boards, but more than in the past, disclose that they used an outside consultant to facilitate all or a portion of the evaluation process".*

Almost all of the 500 boards perform board evaluation yearly (99%). Full board and committees are assessed by 54% of corporations; 32% evaluate the full board its committees and individual directors, as noted above; 10% of companies only evaluate the board as whole; and finally, 4% conduct an evaluation of the full board and its directors.

Only thirteen boards reported that they had been assisted in their assessment process by an independent third party, usually a consulting firm. These independent experts may conduct the evaluation process fully or in part.

The real world: company practices

This section presents some examples of company practices extracted from their published annual reports. The sample is certainly limited. The first two examples are from the top-ranking firms in good corporate governance in UK and USA, respectively, British American Tobacco Plc. and Microsoft Corporation.

On the UK side, the British Institute of Directors (IoD) ranks the FTSE 100 based on their corporate governance performance. According to the report, IoD follows "*two different approaches to measuring the corporate governance of a given firm:*

- *We select a list of objective, measurable factors drawn from public sources*
- *We conduct a survey of stakeholders' perceptions of corporate governance"*

Most interestingly IoD emphasizes the fact that:

"…our methodology shows that the naïve approach of giving equal weights to different indicators (often adopted in the past) is inappropriate. Surprisingly, measures of Board Effectiveness have little effect on the perceived quality of corporate governance of a company. This is probably due to the fact that Board Effectiveness is hard to measure and that simple compliance with the UK CG code is not enough to receive a high CG score as perceived by stakeholders." British American Tobacco Plc ranks first with 793 points. This is the reason to include it here as a very fine example.

For the second consecutive year, Microsoft Corporation is the top company in the ranking published by the prestigious Corporate Responsibility Magazine (CRM). Elliot Clark, CR Magazine's CEO, highlights the fact that "*this annual list is the only ranking that doesn't rely on self-reporting [….]. Each year, we measure the most transparent companies who report on their responsible practices. Our goal is to advance corporate accountability and responsibility."* The 2016 ranking was based on seven categories: Environment, Climate change, employee relations, human rights, corporate governance, financial performance, philanthropy & community support.

These two examples are complemented by three additional ones following a geographical criterion. The aim was to check how widely spread evaluation practices are as well as if there are significant differences among countries and continents.

British American Tobacco. BAT is among the world leaders in tobacco manufacturing. Founded in 1902 and based in London, in 2016 the company sold 665 billion cigarettes, made in 44 factories in 42 countries.

The information offered by BAT, in its 2016 Annual Report, about its board activities and evaluation practice is probably the most complete of many companies reviewed in the research process for this work.

Board activities are classified in five categories: growth, productivity, sustainability, winning organization and board effectiveness. A summary of the described board's activities follows.

Growth:

- Consideration of industry trends and the competitive environment for tobacco products and next generation products.
- Reviewing the implementation of the Group's strategy in the context of evolving global trends, in particular the slower economic recovery and its impact on emerging markets and changing consumer preferences.
- Agreeing key strategic imperatives to ensure that the Group strategy remains relevant and appropriately targets key growth segments.
- Receiving and agreeing to pursue M&A strategic and tactical opportunities for growth.
- Reviewing operating performance and the continued impact of foreign exchange rates on the Group's financial performance, including measures taken by management to mitigate the foreign exchange risks.
- Reviewing the quarterly financial performance of the Group's associate companies, Reynolds American Inc. and Imperial Tobacco Canada.

Productivity

- Monitoring the final stages of the roll-out of the Group's new operating model and global IT solution.
- Working through the Audit Committee to conduct a compressed audit tender process to appoint new Group Auditors.
- Reviewing the Group's trade marketing and distribution resources, including the proposal to leverage the Group's Direct to Store Distribution (DSD) networks in the Americas, in order to achieve further efficiencies and cost savings.
- Regularly reviewing the Group's liquidity, confirming that the Company conforms to its financing principles, and noting planned refinancing activities for the year ahead.
- Monitoring the Group's IT security threat assessment process.

- Reviewing progress on the merger of the Group Legal and the Corporate and Regulatory Affairs functions to form a combined Legal and External Affairs function.

Sustainability

- Receiving updates on the Group's Next Generation Products business, including a new organizational structure and strategy for the Vapor Products and Tobacco Heating Products business.
- Reviewing performance following the launch of the Vype e-stick and Vype e-pen and proposed timelines and markets for future launches, including the "glo iFuse" Tobacco Heating Product.
- Monitoring progress made by the Group in securing regulatory approval for its nicotine inhalation product, Voke.
- Approving Group-wide Vapor Marketing Principles to govern the Group's advertising and promotion of these products.
- Monitoring the status of the Group's litigation proceedings.
- Reviewing the Group's regulatory strategy in the context of the current regulatory landscape, including plain packaging proposals within the EU and the Group's legal challenge to the UK Government's proposed new packaging rules.

And other additional activities within the sustainability category.

Winning organization

- Reviewing the results of the Group-wide survey of employee engagement undertaken in late 2014, where all categories had improved compared to the 2012 survey and scores in many categories were higher than the average for comparable companies.
- Receiving updates on the difficulties of attracting and retaining talent and taking this into consideration for revising talent and remuneration policies.
- Reviewing the application and continuing impact of the Remuneration Policy during 2015; agreeing proposals for a revised Policy and consulting with key shareholders regarding the said proposals.
- Reviewing the development of leaders in the Group, in particular activities to drive

a high-performance leadership culture, including a revised performance management system to develop diverse leaders at all levels and a focus on external recruitment using social media.

- Receiving updates on the Group's diversity goals with particular focus on gender and nationality diversity at senior positions.
- Reviewing detailed succession planning at board level, including executive director and management board succession planning, and monitoring the progress of management board members development plans.
- Reviewing the performance of the executive directors and management board members.
- Considering non-executive director appointments proposed by the Nominations Committee and appointing three new non-executive directors; reviewing and refreshing the composition of Board Committees.

Board effectiveness

- Diversity: "*Our Non-Executive Directors come from broad industry and professional backgrounds, with varied experience and expertise aligned to the needs of our business [...] In 2015 over 30% of our Board was female."*
- Board induction and other training programs: *On joining the Board, all Directors receive a full induction. Non-Executive Directors also receive a full program of briefings on all areas of the Company's business from the Executive Directors, members of the Management Board, the Company Secretary and other senior executives. Sue Farr, Pedro Malan and Dimitri Panayotopoulos received a comprehensive induction in 2015 including briefings covering the Group's Strategy, its functions (including Marketing and Next Generation Products), statutory reporting cycle, Group Treasury, IT strategy and legal and regulatory issues. They, along with the rest of the Board, also had the opportunity to visit the Group's Regional Product Centre in Brazil. A visit to a factory is planned for 2016 to complete their induction.*

BAT's board evaluation process is described in the following table:

BAT board evaluation
The performance and effectiveness of the Board, its Committees, the Executive and Non-Executive Directors and the Chairman have again been assessed internally, using questionnaires produced with the assistance of the online governance assessment service, Thinking Board. For each question, Directors were requested to rank the Board against a number of questions. They also had the opportunity to provide specific comments. Constructive feedback Reports were prepared by the Company Secretary for the Board and each Board Committee on the results of the evaluation. In addition, the Chairman received reports from the Company Secretary on the performance of each of the Executive and Non-Executive Directors. A report on the Chairman's own performance was prepared by the Senior Independent Director. Individual feedback was given by the Chairman to all Board members, and by the Senior Independent Director to the Chairman. The results of the evaluation show that the Board continues to function very well and each of its Committees continue to be efficient and effective. All Board members are considered to be making an effective contribution to the Board and Board discussions.

(Source: BAT Annual Report 2016)

The areas reviewed in the board evaluation include: leadership, oversight, meetings, support, composition and working together. For each category, BAT's Annual Report specifies the findings and the actions planned for 2016 based on the evaluation results, as shown in the following two pages of the report.

Board evaluation 2015

Leadership

"Good discussion about the Company's performance with the right degree of challenge on the performance of the business"

Findings

The Board continues to have a dear understanding of the Group's business and the environment in which It operates. Strategy is continually reviewed with management and its focus refined as necessary. "There is an excellent balance between the long and short-term views in a very dynamic global market?

There is a good understanding of the risks to the business, Including reputational risks. The continuing importance and the value of the market visits, particularly for the Non-Executive Directors, was rated highly although as a global organization it Is recognized that not all Regions can be covered each year.

The Executive Directors and senior management are well regarded.

Action for 2016

Continue to ensure that the Board receives timely briefings on the development and progress of strategy and on the challenges and opportunities facing the sector.

Earlier Involvement in strategy development could allow more input from the Board, in particular around different scenarios and alternative strategic proposals.

Progress against 2015 actions

To assist the Non-Executive Directors In understanding fully the challenges and opportunities facing the Group, the annual Strategy meeting was held in Brazil where the Board received presentations on leaf and product issues, discussed regional issues with senior management and visited a tobacco farm and the Regional Product Centre.

Additional Board training sessions were held on the Group's Brand Building activity and the Next Generation Products businesses which provided further opportunities for Board interaction with senior managers in the Marketing and Next Generation Products functions.

Oversight

NEDS demonstrate "a willingness to understand the business in depth"

Findings

The Board has effective oversight of the business and a good understanding of the business drivers.

The Group's Audit and Corporate and Social Responsibility Committee framework, and risks monitored by the Board in this context, continues to work well.

Group performance against a range of measures was reported to the Board by the Chief Executive and the Finance Director in regular Board updates.

Action for 2016

To provide further context for Board discussions, more regular 'deep dives' into the performance and published strategies of the Group's key competitors will be scheduled. More regular reviews of shareholder and media views of the Company will be sought directly by the Board to help challenge the Board's assumptions.

Progress against 2015 actions

The Board reviewed detailed proposals on defining and setting the Group's risk appetite and considered the viability of its business model relative to its principal risks.

Market visits conducted during the year allow senior managers greater access to Non-Executive Directors and vice versa, increasing the Board's confidence that effective oversight and a detailed line of sight is prevalent throughout the organization.

Meetings

"Well managed in terms of scope, complexity, efficiency and time management"
"Thorough documentation"

Findings

The annual Board program continues to be comprehensive with all key issues being covered. Papers are of a high quality with very thorough documentation.

Meetings enable good discussion about the Company's results with the right degree of challenge on performance issues.

Views are presented clearly. Meeting times may be extended and discussions often continue over dinner, without management being present, to allow full and frank discussion.

Action for 2016

Committee memberships and the scheduling of Committee meetings will be reviewed during 2016, with a view to maximizing the effectiveness of each Committee, and of the Board, within the overall time allocated for each meeting schedule.

Non-Executive Director-only discussions have been particularly valuable during 2015 and these will continue to be scheduled during 2016.

Progress against 2015 actions

Non-Executive Directors received regular functional briefings on the Next Generation Products business, M&A and litigation matters during 2015, and briefings on operational and regional issues during the market visit to Turkey and the Strategy meeting in Brazil.

Collective Board effectiveness

Collective decision-making

The Chairman seeks a consensus at Board meetings but, if necessary, decisions are taken by majority. If any Director has concerns on any issues that cannot be resolved, such concerns are noted in the Board minutes. No such concerns arose in 2015.

When required, the Non-Executive Directors, led by the Chairman, meet prior to Board meetings and without *the Executive* Directors present. The Executive and the Non-Executive Directors also meet annually, led by the Senior Independent Director and without the Chairman present, in order to discuss the Chairman's performance.

Board evaluation 2015		
Support	**Composition**	**Working together**
'The administrative and secretariat support is first class and much appreciated"	"The approach to succession planning and the oversight exercised by the Board represents very best practice"	'Working well together as a group" "Cohesion and active participation of all"
Findings The Board continues to receive good support from management and the secretariat. All Non-Executive Directors appreciate the level of training and support they receive in performing their duties. As mentioned on page 55, the Chairman meets each Non-Executive Director individually, each year, to discuss their training and development needs. **Action for 2016** Regular, relevant training on legal duties and corporate governance will continue to be provided, for example on the new Market Abuse Regulations. **Progress against 2015 actions** All new Non-Executive Directors completed a detailed induction covering all aspects of the business where they have been able to meet all of the Management Board members and Heads of Function. The final element, a factory visit, is planned for 2016. Training sessions for the Board have been held on brand building activity and on the development of the Next Generation Products business.	**Findings** The addition of new Non-Executive Directors with branding and marketing experience is seen as "a real plus" given the Group's operations in the FMCG sector. The Board has broad and diverse skills, experience and talent. The Board mix meets current and future needs and benefits from the right mix of personalities and styles. The Board also deals with transition and long-term planning well. **Action for 2016** The succession needs of specific Committees, as opposed to the Board as a whole, will be a focus area in 2016. The appointment of Non-Executive Directors with diverse skills, nationalities and gender will continue to support the Group's diversity and strategy ambitions, particularly in light of the retirement of one female Non-Executive Director In 2016. Succession contingency plans will be kept under regular review. **Progress against 2015 actions** The Board refreshment exercise undertaken in 2014 and early 2015 culminated in the appointment of three new Non-Executive Directors In February 2015. Each of the new appointees brings identified skills to the Board, whether consumer goods marketing experience or business and geopolitical skills.	**Findings** The Chairman creates a culture of openness, respect and trust and creates opportunities for discussions with the Non-Executive Directors, individually and collectively. Difficult discussions with regards to the impact of the current Remuneration Policy on recruitment and employee relations were handled sensitively. The Chief Executive and the Chairman have a good working relationship; in addition, the Board works within a consensus position, once established. The change of auditor was noted as being an example of a united Board working well and being effective to achieve a desired outcome in a very tight timeframe. The Directors scored each other highly on teamwork and relationships in the Director 360-degree review. **Action for 2016** Ensure that market visits and opportunities to engage with senior management continue as these not only give confidence to the Board that strategy implementation is aligned, it also provides context for succession planning discussions. **Progress against 2015 actions** In addition to the opportunities to meet senior managers provided by the market visit to Turkey and the Strategy meeting in Brazil, the Board budget meeting in December was also attended by all members of the Management Board.

Microsoft Corporation. As previously stated, Microsoft ranks as the number one US company in corporate governance good practices. It emphasizes the independence of the board and its committees. The chairman is independent from the CEO and nine of the eleven directors are independent as well. Independent directors are allocated special time in board meetings to discuss issues without the presence of top managers.

Microsoft also strives to continually educate board members. There are orientation programs in place for new board members as well as other programs to further develop directors' skills and knowledge. "*These programs may include internally developed materials and presentations, programs presented by third parties, and financial and administrative support to attend qualifying academic or other independent programs*" (Microsoft Annual Report 2016). The board is deeply involved in the company's strategic issues, working together with top management to define Microsoft's mission and long-term strategy.

The company conducts an internal evaluation of the board and its committees. The goal is to assess performance, the degree of compliance with Corporate Governance Guidelines and identify the areas in which the board can improve its performance.

However, Microsoft does not specify in its Annual Report the process followed to evaluate the board nor the results and action plans developed as a consequence of the evaluation findings.

GLENCORE board evaluation 2015. Glencore, an Anglo–Swiss multinational commodity trading and mining company, in 2015 appointed Spencer Stuart to conduct an evaluation of its board's effectiveness. The assessment targeted the four committees and each of the individual directors as well. The process, outcome and conclusions is discussed below against the backdrop of each topic's relevance and applicability.

In terms of the process, formal interviews were carried out with each director, top managers including the head of internal audit and the CFO, two representatives from investors and the independent auditor's (Deloitte) leading partner. Feedback was asked from directors regarding their fellow directors' and the chairman's respective contributions. Board dynamics and procedural information was gathered, among other occasions, during several full board meetings and gatherings, in order to assess a real-life situation and the functioning of the board in practice.

The board saw the final report of the evaluation for the first time at a full board meeting. Subsequently, the chairman conducted performance feedback sessions with each director. The lead independent director discussed his evaluation with the board chairman.

The outcomes in this example were generally positive. The overall satisfaction level was good. Nevertheless, an action plan was developed to improve board effectiveness. The action items include one additional meeting of the entire board while at the same time increasing the length of selected meetings. They also decided to add new topics to their agenda for the following years. Special attention will be given to the planning of long-term succession of board members, the task will be undertaken by the nominations committee as well as by the board itself. Finally, it was agreed that the evaluation and review of the board will continue in the future as a fruitful exercise for improving the overall board effectiveness as well as that of its individual directors and committees.

SATS - 2015. The Singapore based SATS Ltd. (Singapore) is the next example studied to add the perspective of an Asian company. SATS is the leading provider of gateway services (airfreight, baggage, ramp handling, cargo, warehousing…) and food solutions (airline catering, food distribution and logistics, chilled and frozen food manufacturing not only to the aviation sector but also to healthcare, hospitality and government agencies), in the Asia-Pacific region.

Its 2015 annual report describes its corporate governance policies and practices according to the principles and guidelines set out in the 2012 company's Code of Corporate Governance. Under Principle 5, and with the assistance of the Nominating Committee, the board conducts an annual formal assessment of its overall effectiveness, individual directors' performance and the contributions from the Chairman.

The nominating committee carried out in Fiscal Year 2015-16 the board appraisal in the form of a questionnaire developed with the assistance of an external consulting firm (Aon Hewitt).

Section 1 of the questionnaire covers several areas of corporate governance, including but not limited to, board composition, information management, board processes, relationships with investors and corporate social responsibility, company performance, strategy and planning, assessment of individual working groups and committees, performance monitoring of CEO and succession planning, management and development of directors individually and as a group, risk management, etc. The collective board appraisal provides the opportunity to gain constructive feedback from each director on the actual effectiveness of their tasks and potential improvements to be

implemented.

Section 2 of the questionnaire concerns individual director evaluations on his/her own performance as well as the performance of his/her peers regarding team integrity, teamwork, individual and collective contribution, ability, personal commitment, knowledge sharing and building, etc. These areas of focus serve the purpose of continuously developing, improving and reinstating maxims for high quality board discussions. The execution of individual director's evaluation allows peers review with the aim of encouraging contributions and enhancing the effectiveness of board members.

Furthermore, private vis-à-vis sessions are held between the chairman and each director to assess issues related to the Board as a whole and to the individual director's performance. It also contributes to a more personalized, constructive and sincere dialogue between director and chairman, allowing them to provide mutual feedback and tackle areas of individual improvement as well as addressing new ways to effectively contribute to the collective board performance. Personal assessment can help the chairman to boost its leadership.

Infosys - 2015-16. Infosys, an Indian multinational corporation that provides business consulting, information technology and outsourcing services, developed its annual corporate report 2015-16 in compliance with global guidelines and standards such as the British Cadbury Report (1992), the Sarbanes-Oxley Act (2002), the Securities and Exchange Board of India (SEBI), the Euroshareholders Corporate Governance Guidelines (2000) and the recommendations of the USA Conference Board Commission on Public Trusts and Private Enterprises. They also adhere to the United Nations Global Compact (UNGC).

In recent years, Infosys has defined corporate governance guidelines to help boards fulfill their corporate responsibility and meet the expectations of company's stakeholders. These guidelines help the board to command the necessary authority and put in place the processes to review and evaluate the company's operations when required. Additionally, these guidelines allow the board to make decisions independently from management.

Regarding the size and composition of the Board, Infosys follows the principle stipulating that, in companies with a non-executive chairman, at least one-third of the board should be independent directors. In fact, Infosys reports to have the right balance between executive and independent directors and they separate functions of governance and management.

The chairman is the leader of the board in charge of ensuring its integrity and promoting a culture of respect and teamwork for the long-term benefit of the company and all its stakeholders. He also chairs board meetings with company shareholders.

The protection and enhancement of shareholder value through strategic direction is among the principal roles of the board. It has the fiduciary duty to ensure that the company has clear goals aimed at increasing shareholder value. The board sets the strategic goals and ensures accountability for its fulfillment. It is also charged with guaranteeing effective management of shareholders' and societal expectations.

Required skills for directors include integrity, expertise and experience in board position, deep understanding in appropriate areas of the corporation and contribution to the company's performance.

One of the main duties of the board is to audit and review its own evaluation criteria, together with the nomination and remuneration committee, to assess the performance of executive and non-executive independent directors.

The evaluation is carried out in the form of a survey which addresses board functioning and effectiveness. The questionnaire evaluates each board member on the effectiveness of board dynamics and relationships, information flow, directors' decision-making, relationship with stakeholders, company performance and strategy, and the effectiveness of the whole board and its various committees. The survey includes feedback from each individual director.

Independent directors have three key roles −governance, control and guidance. Their evaluation is based on the following performance indicators:

> "• *The ability to contribute to and monitor corporate governance practices.*
>
> • *The ability to contribute by introducing international best practices to address*

business challenges and risks.

- *Active participation in long-term strategic planning.*
- *Commitment to the fulfillment of a director's obligations and fiduciary responsibilities; these include participation in Board and committee meetings".*

In summary, company practices are similar around the world. Firms are striving to improve the composition of their boards, increase diversity, devote the right amount of time to board work, implement effective succession plans, comply with regulations, control risk and evaluate board effectiveness. Nevertheless, board evaluations rarely seem to lead to successful action plans that are adequately followed through and monitored. They seemingly do not generate more and better contributions from boards to the companies they serve.

The particular case of Spain

Corporate Governance and board practices in Spain are evolving in line with the prevailing international trends, but progress is slow. Crif Ratings (a European rating agency working mainly in Italy and Spain) in its 2016 report on Spain states that: *"despite the recent improvement as a result of companies' voluntary decisions there is still quite some room for improvement to comply with best practices".*

Until 2007 very few had considered the need to evaluate boards, its members and its committees. Following the 2008 global economic crisis, concern about good governance practices increased substantially.

Call for attention (2009). A joint research study by Russell Reynolds and IESE Business School (2009) covered the perspective of institutional investors as well as that of board chairmen. The sample of institutional investors represented 30% of transactions in the Spanish equity market by March 31, 2009. To reflect the point of view of board chairmen, 28 individuals (17 board chairmen and 11 persons appointed by their chairmen) were interviewed. They all belonged to top Spanish publicly traded companies.

On the institutional investor side, the company's governing structure is a crucial factor driving their investment: 51% of responders considered this fact important or very important to decide where they want to invest. Only 28% considered this somewhat important.

Institutional investors also rated very highly the following aspects:

- Ownership structure of the company: 89% of the sample.
- Who is the top executive: 79%.
- Who is the chairman of the board: 62%

According to institutional investors Good corporate governance depends on:

- Information transparency: 96% of the sample.
- Fairness in treating shareholders: 92%.
- Remuneration of top executives and directors aligned with company goals: 86%.

According to this 2009 study, institutional investors find boards lacking in:

- Fulfilling the expectations of company stakeholders: 42% of the interviewees considered this a significant failure.
- Maintaining the board's independence from company top management: 41%.
- Supervising and measuring company performance through internal controls deeply embedded in business processes: 35% of respondents.

Regarding availability of director desired profiles in Spain, institutional investors point to the following deficiencies:

- Lack of experienced foreign directors as well as lack of knowledge of domestic market: 78% of responders considered this an obstacle in the path of board effectiveness.
- Lack of knowledge about international markets: 67% of respondents.
- Lack of Spanish directors with international experience: 56%.

An overall view backed by 75% of the interviewed institutional investors was that company governing bodies were highly or very highly responsible for the general economic crisis and most in particular for the failures of financial institutions. They were in agreement that there was substantial room for improvement. They cited the following improvement areas:

- Improve risk management and control.
- Ensure director independence from top executive(s).
- Promote directors' professionalism.
- Encourage directors' greater involvement.
- Evaluate boards of directors and their real impact on company performance.
- Ensure greater protection of minority shareholders.
- Improve the regulator's role.
- Adopt good corporate governance practices.

It is worth noting that, in 2009, institutional investors were already considering board evaluations as a tool for increasing board effectiveness.

Board chairmen share many of the opinions and concerns of institutional investors, but there are also a number of differences. As to what makes a good director, they pointed to the following:

- Knowledge of global markets: 78% of the interviewees.
- Experience in controlling and internal auditing: 73%.
- Previous experience as top executive: 67%.
- Personal networks: 59%.

The less valued assets for board chairmen regarding directors were:

- Personal affinity of directors to chairman: 48% found this unimportant.
- Personal affinity to investors: 48%.
- Personal affinity to other members of the board: 40%.

Chairmen, as well as institutional investors, are concerned with the difficulty of finding foreign directors experienced in the Spanish market; also with the scarcity of Spanish directors experienced in the company's industry. Interestingly, the authors note that "*they are highly surprised by the fact that one in two companies does not even consider the need to add foreign board members to their organization*".

As top obstacles to add new directors to their boards, 77% of chairmen referred to the non-existence of the desired profile; 74%, to the existence of legal incompatibilities; and 41%, to the lack of availability of potential candidates.

As main board shortcomings chairmen point to the lack of directors with the appropriate profile (international experience, in particular); the lack of gender diversity; the emphasis on the short-term perspective and the subsequent absence of long-term strategic vision; the scarce time devoted to preparing meetings and to the decision-making process; and the need for more transparency and greater accountability for failure.

An interesting fact emerging from the survey is that 64% of chairmen interviewed believe that existing corporate governance devices are highly or very highly responsible for the economic crisis, particularly within the financial industry. As for the future challenges boards face they named the following:

- The need to come out stronger from the economic crisis.
- The need to strengthen the strategic vision of boards.
- The need to increase gender diversity.
- The need to improve relationships with company investors.
- The need to treat all shareholders fairly.

Dysfunctional boards (2013). Professor Jaume Llopis from IESE business school (Qué hacen los Buenos Directivos, article published by IESE in 2013) explicitly stated that boards of Spanish companies were totally dysfunctional. He also contended that 98% of boards did not evaluate their directors' performance. Professor Llopis had served in 40 boards and only two of those 40 corporations evaluated their boards. He goes on to say that: "*Directors of the Ibex 35 companies receive €280,000 in average*

annual compensation. If there are no tools in place such as evaluations, how can they be accountable for the work they carry out every year?" And later in the same article he claims that "*with active, rigorous and honest directors, episodes such as those of Pescanova, Bankia, Fagor, the saving banks' bankruptcy… could have been avoided.*"

The Fundación Compromiso y Transparencia (Commitment and Transparency Foundation) in that same year 2013 published a report entitled "Reinventing Boards" which is a very critical analysis of the transparency of Spanish boards. The report's author –Javier M. Cavanna, chairman of the foundation− studies the degree of "voluntary" transparency in the web sites of the 35 companies comprising the Ibex index. He is astonished by the "*ignorance*" of academic specialists on the nature of good governance. Cavanna goes as far as stating that the specialists' ignorance is *"in inverse proportion to the number of publications on the subject."* He also contends that there is no practical value for companies in the contents of researchers' papers and articles.

According to the author, the initiative to analyze their performance should not come from regulators or overseeing bodies, but from the boards themselves. They should prioritize the development of the relevant devices to permanently improve their performance. The following criteria are examined by the author:

- Transparency.
- Independence.
- Power distribution.
- Strategy and risk control.
- Director appointment and performance evaluation.
- Education and time devoted.
- Remuneration.
- Term and succession.
- Diversity.
- Dialog.

The top 35 Spanish public companies did not score high in these parameters. Regarding transparency, only 4 companies (Abengoa, BME, Inditex and Santander), or 12% of the sample, include in their website the required information.

The vast majority, 97% of companies, had no independent directors at the time. Only 26% had a dual structure, that is to say, the individual chairing the board is different from the CEO. Regarding the strategic and supervising function none (0%) of the 35 Ibex corporations disclosed any information on their websites.

One of the real weaknesses shown by Spanish companies –and many other countries as well− is the lack of attention by boards to their strategic and risk control functions. None of the companies studied (0%) presented any information about this area. In fact, four years later, it is still considered one of the aspects with the highest improvement potential, as we shall see.

Regarding criterion number 5: director appointments and performance evaluation, the 35 Ibex companies (100%) comply with the legal requirement that stipulates the existence of a nomination committee and requires companies to inform about the composition, structure and functioning rules of the said committee. But only one company (Banco Santander) complies with the specific requirements regarding the nomination committee's report. At the time the research work was published, only one company (Iberdrola) provided information about the content, results and processes followed in the evaluation. Most companies stated that they had performed the board evaluation but published no information about it. Mr. Cavanna considers that it is understandable that many firms deem it confidential information. It happened in other parts of the world as well. For instance, 96% of companies in the 100 FTSE perform evaluations but only 31.3% publicly share their contents, processes and results. This relatively high percentage demonstrates the fact that disclosure of information about the results of performance evaluation does not necessarily imply a threat to companies. The author reminds us that the "*transparency and quality of information presented by companies contributes to improve their credibility and generates more trust among analysts and investors*."

He also comments on the usefulness of evaluations indicating that board evaluations are:

> "*…not a device to identify and point out mistakes, but a tool to enhance board capacities. Evaluations enable boards to know if all their members are prepared to face future challenges; they also allow them to identify the potential need to enhance knowledge in a particular subject matter; to advance diversity both in gender and perspectives; and, finally, evaluations provide valuable information to replace or add members*". (Own translation)

Training of directors and time devoted to the organization they serve does not score high, since, according the author of this report, 82% of companies do not comply with the indicators in this area. Firms are required to provide the information about training programs attended by directors. More specifically, training in best governance practices is considered crucial by the Unified Code of 2006, as well as training new members of the board. Mr. Cavanna points out that 97% of Ibex 35 companies state that they comply with the training requirement, but only one (Banco Santander) provides specific information about this topic. None present any data about time spent by each director in tasks related to the board (training, preparation of meetings and attendance to meetings).

Information about remuneration is also lacking. A high percentage of the 35 companies (94%) present information about the remuneration model, since it is mandatory according to the Unified Code of 2006. However, none of the firms provide any data about individual director remuneration. Visibility of the remuneration information is also considered by the study. It concludes that most companies include the remuneration information within the section about the shareholders' annual general meeting.

There are though positive exceptions and companies such as Iberdrola, Indra, Santander or Telefónica publish their remuneration report as a special section within the corporate governance report.

Regarding the term of mandate for directors, 44% of Ibex 35 companies had indeed stipulated a maximum number of years for directors serving in their boards, but 56% of them had not established a limit by 2013. Succession plans did not exist at all at that time. In this respect, Mr. Cavanna comments that "*the lack of information provided about succession plans by Ibex companies is alarming, given how critical this is for risk management and, as it was previously pointed out, given as well the fact that succession planning is one of the key drivers of board effectiveness*" (own translation).

Diversity in corporate boards was not a priority in Spain in 2013 and most in particular gender diversity. None of the companies had defined any goals concerning this element of board composition; and only 11 companies (32%): Bankinter, DIA, FCC, Gamesa, Iberdrola, IAG, Banco Popular, REE, Repsol, Sabadell and Sacyr present information about measures taken to achieve a higher percentage of women in their boards.

According to Mr. Cavanna, dialog with shareholders and stakeholders also scored low. None of the companies were providing any information about their efforts for maintaining a real conversation with shareholders through a dedicated forum and with stakeholders as part of their corporate social responsibility activities. Only five companies (15%) −Acciona, Iberdrola, Repsol, REE and Telefónica− had at that time a specific board committee in charge of social corporate responsibility.

The response of regulators. The year 2015 was meant to be a turning point. The Spanish corporate governance model had to change. First it was through the issuing of Law 31/2014 amending the LSC (Ley de Sociedades de Capital or company governing law) which came into force on January 1, 2015. Then, on February 24, 2015, the new Government code for publicly traded companies (CBG, as it is known by its Spanish acronym). The amendment of LSC was aimed at generating higher trust among domestic and international investors.

The new governance code amends and expands the previous Unified code of good governance for publicly traded companies of 2013 (an update of the 2006 code). Among other novelties, the new code of good governance stipulates the obligation to evaluate boards and their committees for all publicly traded companies in Spain.

Recommendation number 36 explicitly asks for the full board to assess itself once a year and to develop an action plan to correct the identified deficiencies regarding:

> *"a) The quality and efficiency of the board's functioning.*
>
> *b) The functioning and composition of the board's committees.*
>
> *c) Diversity in the board's composition and its competences.*
>
> *d) Performance of the board chair and the company's first executive.*
>
> *e) Performance and contribution of each director, particularly those of the*

directors in charge of board committees.

Committees will be evaluated based on their own report to the board; evaluation of the board will be based on the report submitted by the nomination committee.

Every three years, the board will be assisted in its evaluation process by an external consultant, whose independence will be verified by the nomination committee.

The existing business relationship with the external evaluator or any company belonging to the said evaluator should be detailed in the company's annual corporate governance report.

The process as well as the areas evaluated will also be described in the company's annual report".

Source: Code of good governance of publicly traded companies, CNMV, 2014. (Own translation).

The current reality. The PwC report on Spanish Boards of publicly traded companies (2015) includes the opinion of the interviewed Spanish directors on the additional recommendations introduced by the new code of governance (CBG). The recommendations which, according to the survey, will have the highest impact on improving boards' effectiveness are:

- The recommendation regarding the need to have 50% of independent directors, with 6.9 points (out of 10).
- The recommendation to perform a board evaluation by an external consultant, every three years, with 6.8 points (out of 10).

The recommendation deemed to have the lowest impact on board effectiveness is the one referring to the enhancement of responsibilities related to corporate social responsibility.

On the subject of board evaluation, the PwC's report (2015) adds the consulting firm's five own suggestions for performing the evaluation:

- *"Conduct at least one annual Board of Directors evaluation, including the board committees and the top positions of the board (chairman, CEO, lead independent director). The individual evaluation of each board member is a consolidated international trend.*

- *The evaluation should be undertaken from a twofold perspective:*
  - *a) Qualitative, through interviews with directors to obtain their opinion on board functioning and the performance of its various components.*
  - *b) Quantitative, through the analysis of parameters that allow the identification of i) degree of company compliance with domestic regulatory demands and recommendations on corporate governance, ii) degree of alignment with international trends and iii) company's position with regard to comparable firms and best practices.*

- *Establish action plans following the evaluation process and follow up the implementation of the said plans.*

- *Make public the top conclusions of the evaluation process and the information regarding the action plans to be implemented".* (Own translation)

Improvements in recent years. *The PwC report* (2015) −data from 2014 FY− offers significant information on the evaluation practices of Spanish boards. The sample includes 50 companies and covers all of those comprising the Ibex 35 index.

Of those 50 companies whose board chairmen were interviewed, 67.5% of them stated that the company conducts an internal evaluation; 22.5% conducts the evaluation with the assistance of an external third party, compared to 15.4% in the previous fiscal year. Only 7.5% conducts mixed evaluations, meaning that they periodically alternate internal and external ones.

The PwC report points out that, in 2013, 15.4% of the sample companies did not perform board evaluations, whereas in 2014 only one company did not conduct an evaluation (2.5%). This proves that Spanish top companies were already anticipating the future legal requirement and perhaps trying to implement international best practices.

In 63% of the sample companies, the evaluation covers the board, its committees and its chairman. Only 4% evaluates individual directors, but this percentage is expected to grow since the new code recommends the evaluation of each member of the board individually. There are 33% of companies in the sample which evaluate the board and its committees only.

The Spencer Stuart report (2016) on Spanish boards of directors comprises 100 publicly traded companies in Spain, including the Ibex 35 c. corporations and is based on information from FY 2015.

The study notes that overall there has been progress and boards are in better shape than in years past. Key achievements are an increase in the number of independent directors and greater transparency regarding board functioning as well as the quantity and quality of the information made public.

Nevertheless, the report concludes that there are numerous companies whose compliance with the requirements of old and new regulations is merely formal.

A positive development is the increasing number of companies that "*firmly believe that good Corporate Governance creates value in the long-term.*"

Among the improvements the Spencer Stuart report highlights are the following:

- *"Boards are progressively increasing performance expectations regarding their own functioning.*
- *High degree of compliance with the new 2015 CBG recommendations.*
- *Increase in the number of companies that send information for board and committee meetings in advance.*
- *Good functioning of the Audit Committee.*
- *Higher involvement of boards in company risk management.*
- *Slight increase of time devoted by boards to company strategy.*
- *Increase in the number of women directors.*
- *Increase in the number of companies that conduct the board self-evaluation assisted by external third parties".*

As areas for improvement the report points out to:

- "*The low number of companies that have developed succession plans for both the chairman of the board and the CEO.*
- *Inadequate time devoted by the board to strategic issues.*
- *High number of companies where the board chairman is at the same time the top executive.*
- *Continued lack of genuinely independent directors.*
- *Need for increased number of foreign directors as well as business savvy directors.*
- *Poor performance of the nomination and remuneration committee, particularly with regard to nominations*".
- *Although numerous companies conduct a board evaluation, this is a merely formal process with little later developments in improvement areas.*
- *Despite improvements, there is still a limited presence of women in boards".* (Own translation)

Some of the most illustrative quantitative data related to the above-mentioned topics are:

- 65% of surveyed companies (60 % in Ibex 35 firms) points out that they do not devote sufficient time to strategic debate in board meetings. Companies usually dedicate just one board meeting to develop and debate the strategic plan (80% of companies). Very few hold a special separated meeting exclusively focused on strategy.

- 80% of surveyed companies send the relevant information, three or more days prior to board meetings and only 28% send this information, seven or more days in advance.

- More than 50% of the interviewed directors consider that the information received is poor, incomplete and not truly useful. They also believe that it is not sent sufficiently in advance to prepare meetings.

- 69% of surveyed companies point out that they do not have in place any training programs for directors. Nevertheless, in their annual corporate governance report almost 100% of companies state that they do have available those training programs.

- 56% of companies have no dual distribution of power: the board chair position and the CEO position are filled by the same person. In Ibex 35 companies this percentage rises to 69%.

- There are just 16% of women in Spanish boards, although it is up from a mere 14% in 2014.

- 36% of the surveyed companies do not limit the number of boards their directors may serve. The most common limit is 4 publicly traded companies.

- 43% of the 100 companies surveyed do not have any foreign directors.

- 72% point to the need for improving the board self-evaluation.

- 43% of directors are independent directors, compared to 84% in the USA, 69% in France or 61% in the UK.

On board evaluations, there are several relevant facts revealed by the report:

- 68% of the sample companies perform an evaluation of the CEO compared to just 57% in 2011.

- 92% evaluate their boards (97% in Ibex companies) compared to 68% in 2011.

- Of the companies that do perform board evaluations, only 25% seek the assistance of an external advisor (43% of Ibex 35 firms).

Nevertheless, 55% of interviewed directors believe that the evaluation process in 2015 was a merely formal procedure with little or no repercussion.

A long way to go. For this dissertation, a number of corporate governance reports from Ibex 35 companies have been reviewed. Their C.1.20 section (as stipulated by current regulations) deals with board evaluation, measures taken as a result of the

evaluation and the evaluation process itself.

According to Javier M Cavanna in his article published in *Compromiso Empresarial* magazine in June 2013 entitled El IBEX 35 suspende en gobierno corporativo (Ibex 35 companies fail in corporate governance):

> *"Part of the problem of the current Unified Code is that it only includes a set of practices based on the functioning of decision making bodies (boards, committees, Shareholder Annual Meetings, etc). This perspective has the advantage of selecting a closed list of good governance practices, but it does not help the appropriate comprehension of those practices and their improvement."*

Examples chosen include Banco Santander and Iberdrola, which offer more detailed information about board evaluations practices. Indra has been selected as a third example, in this case, of poor information on board evaluation facts.

The most complete information comes from **Banco Santander**. The company refers to some specific actions adopted in 2016 following the 2015 board evaluation. These include the following:

- Meetings to be held yearly to analyze matters of strategic interest to the Group.
- Information to be sent to board members on all opinions and reports issued by financial analysts and institutional investors regarding the Bank.
- Board composition to be adjusted by incorporating new independent directors with a more international profile, while strengthening diversity and increasing board expertise in digital strategy.
- More preparatory meetings to be held in the lead-up to actual board members so as to improve relations between directors and encourage interaction between board members and company executives.
- Board to become involved in managing talent by setting up talent committees tasked with assessment processes and succession plans and reporting to the appointments committee and the board.

Banco Santander has included in its Board Rules (article 19.7) the performance of an annual evaluation of the functioning of its board and its committees, the quality of their

work and the individual performance of each member of the board, including the board chairman and the company's CEO. Board Rules also refer to an evaluation performed with the assistance of an external consulting firm. The last board evaluation conducted in this manner took place in FY 2015.

Banco Santander offers too some information about the evaluation process. The process is based on information obtained from directors through an ad-hoc questionnaire which is confidential and anonymously submitted. Interviews are also part of the process. The chair of the nomination committee personally interviews board members. Independent directors evaluate the lead director. The lead director oversees the evaluation process of the chairwoman.

The overall evaluation of the board focuses in on its structure, organization and functioning as well as its dynamics and internal culture; it also touches on issues such as board knowledge and diversity, its control and supervision function and strategy matters. Evaluation of the various committees follows a similar pattern but it focuses in on the support and information provided to the board. The lead director evaluation takes into account its leadership role, relations with institutional investors, evolution of his/her *role* and other additional topics.

A positive feature of Santander's annual report is that it is frequently updated. Here is what it says (English version of the report) about the conclusions of the 2016 evaluation process:

> *"The report containing the conclusions and results of the assessment process for the board and its committees in 2016 was presented at the board meeting held on 24 January 2017. In view of these findings and the results of the business reports of the various committees in 2016, the board approved an action plan that envisages improvements in the following areas, among others:*
>
> - *Increase the time dedicated to digital transformation and technology, human resources, succession and talent, strategic, cyber-security, competitor landscape and innovation.*
> - *Strengthen coordination among committees of the Group entities, especially regarding the audit, appointments and risk supervision, regulation and compliance committees.*

- *Monitoring and updating verified and robust succession plans for the board of directors, its committees and the senior management.*

As noted above, the energy sector provides another example of good practice in board evaluation. **Iberdrola** offers general information on the most frequent parameters of board good practices such as the increase in 2015 in the number of independent directors (71%, from 64% in 2014). Improvement of communications and transparency towards shareholders: in 2015 for the first time in its history, Iberdrola published an annual report on involvement and contacts maintained with shareholders). It has also published for the first time a report about the work of the company board and its committees.

The most relevant information provided by Iberdrola about board evaluation refers to the process applied and to the fact that a consulting firm (PwC) assisted the company in its evaluation effort.

With respect to process their governance report states that it:

> "*Comprises approximately 500 objective, quantifiable and measurable parameters, which are annually updated according to latest trends and changes in regulation*" (own translation).

The analyzed fields include:

- Compliance with current regulations and with the internal rules of the company.
- Comparative analysis with comparable national and international companies.
- Accordance with most advanced trends in corporate governance.
- Degree of accomplishment of action plans established in previous years.

The 2017 action plan based on the board evaluation of 2016 focuses on three priorities:

- Supervision and follow up of the implementation of company strategy, governance model and business model.
- Continuous development of the board's capacities. In particular, progress should be made in orientation programs for newly appointed directors and training programs for other board members.

- Analysis of remuneration trends in boards.

The consulting and technology firm, **Indra**, in its annual corporate governance report (English version) includes only the following paragraph on board evaluation:

> "*The evaluation process [...] was performed with the collaboration of external advisors (Egon Zehnder) and consisted of a questionnaire and an interview by the consultants with each of the Directors. The resulting report concluded that regarding its composition and duties the Board of Directors is appropriate in its size and in the professional profiles of its membership, and that the selection process for its members is done in a structured and objective fashion. As regards the Committees, it was concluded that their structure is appropriate, that they have an important role in corporate governance of the Company, and that they act in an effective manner. It was noted particularly that they perform independently and it was concluded that they provided adequate information to the Board as a whole, providing Directors access to information and apprising them of the activities of the committees. Finally, the evaluation concluded that the performance and input of each Director was individually satisfactory*".

Finally, there are Ibex 35 firms who do not provide any information about their board evaluation processes. Such is the case of one of the top Spanish insurance companies, **Mapfre**. The only sentence devoted to the subject is the following: "*The evaluation has not generated any significant changes*." (Own translation).

One has to agree with the many directors interviewed by consulting companies that, in Spain, evaluations are −in the vast majority of cases− a merely formal process conducted with the aim of complying with the regulator's requirement. In a high percentage of publicly traded companies' evaluations are meaningless and they still do not contribute to increase the overall effectiveness of boards.

Furthermore, as we have seen, both in the international (IoD) and domestic scenes (Cavanna and his Commitment and Transparency Foundation) there are critical views about board evaluations, how they are conducted and their efficiency as a tool for improving board performance.

Finally, to conclude this section, I must refer to the highly surprising fact that evaluations are conceived as a means of analyzing and comparing boards among

themselves and to best practices around the world. Yes, it is true that the degree of independence, the diversity of gender and perspectives, board dynamics, the behavior of committees and so on and so forth determine the quality of the board functioning and its overall effectiveness. Nevertheless, there is a fundamental question that does not seem to be addressed by evaluations –how, what and to what extent does the board contribute to the achievement of company goals and the implementation of company strategy. We will later return to this most important topic.

Main tool for board evaluation: questionnaires

As we have already seen, there are several tools used to conduct board evaluations, such as interviews, observers in meetings and most ubiquitous are questionnaires. A complete example is presented below. It has been developed by the Austrian working group for corporate governance (February 2005) and designed for the voluntary external evaluation of compliance with the Austrian code of corporate governance.

It aims at maximizing uniformity and continuity in evaluation practices to ensure a high level of comparability for evaluation results. It also aspires to facilitate public insight into compliance with, and achievement of the corporate governance guidelines. The use of this questionnaire is voluntary in Austria.

With the help of this questionnaire, investors, in this case, are able to quickly assess the corporate governance situation of their corporations. The questionnaire checks for the rules of the code in line with the "comply or explain principle". The comment fields help the evaluating institution to further illustrate whether or not the non-compliance with a rule is sufficiently explained by the company. When choosing an institution to conduct the evaluation, it is crucial that the institution is independent from the evaluated corporation.

Below you will find the full questionnaire in all its detail.

#	Question	Comply	Explain	C
Shareholders and shareholders' meeting				
	Does the company have the principle of "one share, one vote", i.e., has the company only issued shares in which each share grants voting rights and no right of delegation to the Supervisory Board?	Yes [] No []	Yes [] No []	

Interplay between supervisory board and board of directors				
	Is there a joint statement by the Supervisory Board and the Management Board that open discussions between Supervisory Board members and members of the Management Board take place in Supervisory Board meetings?	Yes [] No []	Yes [] No []	
	Is there an opinion from the Management Board that open discussions are taking place between board members in board meetings?	Yes [] No []	Yes [] No []	
	Are the documents for Supervisory Board meetings usually made available at least one week before the respective meeting?	Yes [] No []	Yes [] No []	
Board of directors				
	Does the board of directors consist of several persons?	Yes [] No []	Yes [] No []	
	Is there a chairman of the board?	Yes [] No []	Yes [] No []	
	Is there a clear division of business and a set of rules for cooperation in the board of directors?	Yes [] No []	Yes [] No []	
	Are the names, date of birth, date of initial appointment and end of the current term of office of the members of the board as well as the division of responsibilities within the board being published in the Corporate Governance Report?	Yes [] No []	Yes [] No []	
	Are supervisory board mandates or comparable functions of members of the board in other domestic and foreign companies, except those included in the consolidated financial statements, listed in the Corporate Governance Report?	Yes [] No []	Yes [] No []	
	Are the communication tasks carried out by the Management Board in material matters?	Yes [] No []	Yes [] No []	
	Has an internal audit been set up as a separate management board of the Management Board or has it been outsourced to a suitable institution?	Yes [] No []	Yes [] No []	
	Is at least once a year reported on the audit plan and significant results in the Audit Committee?	Yes [] No []	Yes [] No []	
	Does the Executive Board report to the Supervisory Board at least once a year about the measures to combat corruption in the company?	Yes [] No []	Yes [] No []	
	Has the Board made arrangements for the provisions of the Issuer Compliance Regulation to be applied by all Group companies (in particular, the establishment of possible confidentiality areas)?	Yes [] No []	Yes [] No []	
	Do the members of the Management Board have no more than four supervisory board mandates (chairman counted twice) in Group-wide stock corporations?	Yes [] No []	Yes [] No []	
	Does the transfer of organizational functions of senior executives in Group companies require the consent of the Management Board?	Yes [] No []	Yes [] No []	

	Was the non-competition clause not removed?	Yes [] No []	Yes [] No []	
	Does the remuneration of the Executive Board contain fixed and variable components?	Yes [] No []	Yes [] No []	
	Are the variable components of the remuneration linked to measurable sustainable, long-term and multi-year performance criteria and do not entail an inadequate risk?	Yes [] No []	Yes [] No []	
	Are non-financial criteria also included in the variable compensation?	Yes [] No []	Yes [] No []	
	Are the maximum limits fixed for the variable remuneration components or as a percentage of the fixed remuneration component fixed in advance?	Yes [] No []	Yes [] No []	
	Is it foreseen that the Company can recover variable compensation components if it is found that these have been paid on the basis of manifestly incorrect data?	Yes [] No []	Yes [] No []	
	Is it agreed that in the case of severance payments, in the event of the premature termination of the Executive Board's activities, there is no entitlement to more than two full-year compensation payments and no more than the remaining term of the Executive Board contract?	Yes [] No []	Yes [] No []	
	Is it agreed that, in the event of premature termination of the Management Board Agreement, no compensation is payable from a major reason for which the Management Board member is responsible?	Yes [] No []	Yes [] No []	
	In the event that agreements have been concluded on the occasion of the premature termination of a Management Board Agreement, do they take account of the circumstances of the departure and the economic situation of the company?	Yes [] No []	Yes [] No []	
	Were there measurable, long-term and sustainable criteria for stock option programs or programs for the preferential transfer of shares for members of the Management Board?	Yes [] No []	Yes [] No []	
	Is a subsequent amendment of the criteria excluded?	Yes [] No []	Yes [] No []	
	Is the holding of an appropriate equity interest in shares of the company planned for the duration of the program, long until the termination of the Management Board's activities?	Yes [] No []	Yes [] No []	
	Is there a waiting period and / or a retention period of at least 3 years?	Yes [] No []	Yes [] No []	
	Does the Annual General Meeting decide on stock option programs and share transfer programs for members of the Management Board and their amendments?	Yes [] No []	Yes [] No []	
	Are the principles for the variable remuneration of the Management Board (in particular the performance criteria, the methods used to determine the fulfillment of the criteria, the maximum limits, the quoted shares and deadlines for any share-based remuneration) as well as any material changes compared to the previous year?	Yes [] No []	Yes [] No []	

	Is the ratio of the fixed and variable components of the total remuneration of the Management Board published in the Corporate Governance Report?	Yes [] No []	Yes [] No []	
	Does the Corporate Governance Report publish the principles of the company pension scheme granted in the company to the Executive Board and its requirements?	Yes [] No []	Yes [] No []	
	Are the principles for claims of the Executive Board published in the event of the termination of the function published in the Corporate Governance Report?	Yes [] No []	Yes [] No []	
	Does the Corporate Governance Report report the existence of a D & O insurance if the costs are borne by the company?	Yes [] No []	Yes [] No []	
	Are the fixed and variable remuneration published separately for each member of the Management Board?	Yes [] No []	Yes [] No []	
	Has the Supervisory Board set up its own rules of procedure?	Yes [] No []	Yes [] No []	
	Are the members of the Management Board who are responsible for the information and reporting, unless they are already regulated by the Articles of Incorporation or by the rules of procedure of the Management Board?	Yes [] No []	Yes [] No []	
	Is the reporting obligation also applicable to subsidiaries?	Yes [] No []	Yes [] No []	
	Does the Rules of Procedure establish the establishment of committees and their decision-making powers?	Yes [] No []	Yes [] No []	
	Will the number and type of committees established and their decision-making powers be published in the Corporate Governance Report?	Yes [] No []	Yes [] No []	
	Were more than 4 Supervisory Board meetings held, if necessary?	Yes [] No []	Yes [] No []	
	Is the number of meetings of the Supervisory Board disclosed in the Corporate Governance Report?	Yes [] No []	Yes [] No []	
	Does the Supervisory Board deal annually with the efficiency of its activities, in particular with its organization and operation (self-assessment)?	Yes [] No []	Yes [] No []	
	Is the Chairman of the Supervisory Board regularly in contact with the Chairman of the Board of Management and discusses with him the strategy, the business development and the risk management of the company?	Yes [] No []	Yes [] No []	
	Has a defined (structured) placement procedure been applied to board appointments?	Yes [] No []	Yes [] No []	
	Has a requirement profile been defined depending on the company orientation and the company situation?	Yes [] No []	Yes [] No []	
	Does the Supervisory Board or a committee pay attention to succession planning during its deliberations?	Yes [] No []	Yes [] No []	

	Has it been taken into account that no member of the Executive Board is legally convicted of a criminal offense which calls into question his professional reliability as a board member?	Yes [] No []	Yes [] No []	
	Do the chairmen report regularly to the Supervisory Board?	Yes [] No []	Yes [] No []	
	Is there a committee that is empowered to make decisions in urgent cases?	Yes [] No []	Yes [] No []	
	Do the committees have a majority of independent members?	Yes [] No []	Yes [] No []	
	Does the Corporate Governance Report publish the number of meetings of the committees and deal with the activities of the committees?	Yes [] No []	Yes [] No []	
	Are the members of the committees and the chairpersons listed by name in the Corporate Governance Report?	Yes [] No []	Yes [] No []	
	Has a Nomination Committee been set up in the case of a Supervisory Board with more than 6 members?	Yes [] No []	Yes [] No []	
	If vacant Supervisory Board mandates were to be filled, were proposed by the Nomination Committee or the Supervisory Board to the Shareholders' Meeting?	Yes [] No []	Yes [] No []	
	In the case of a Supervisory Board with more than 6 members, was a remuneration committee established or were these matters transferred to the Nomination Committee?	Yes [] No []	Yes [] No []	
	Does the remuneration committee review the remuneration policy at regular intervals?	Yes [] No []	Yes [] No []	
	Does the remuneration committee include at least one person with knowledge and experience in remuneration policy?	Yes [] No []	Yes [] No []	
	Is it ensured that any adviser to the Remuneration Committee does not at the same time advise the Management Board of remuneration?	Yes [] No []	Yes [] No []	
	Does the Chairman of the Supervisory Board once a year inform the Annual General Meeting of the principles of the remuneration system?	Yes [] No []	Yes [] No []	
	Do the members of the Supervisory Board not have any organizational functions in other companies that are competing with the company?	Yes [] No []	Yes [] No []	
	Were there any conflicts of interest which have arisen as a matter of interest to the chairman of the Supervisory Board?	Yes [] No []	Yes [] No []	
	Were no loans (goods and money loans) granted to a company which does not have authorization for banking transactions?	Yes [] No []	Yes [] No []	
	Are the agreements subject to approval and the respective remuneration published in the Corporate Governance Report?	Yes [] No []	Yes [] No []	
	Are the remuneration of members of the Supervisory Board (including the meeting fees) published separately in the Corporate Governance Report?	Yes [] No []	Yes [] No []	

	Are no stock option plans planned for Supervisory Board members in principle? If, exceptionally, stock option plans are granted to members of the Supervisory Board, have they been adopted in detail (i.e., the conditions of exercise, the number of options, the option price and the retention period)?	Yes [] No []	Yes [] No []	
	Does the number of members of the Supervisory Board exclude employee representatives not more than 10?	Yes [] No []	Yes [] No []	
	Has every new member of the Supervisory Board informed himself adequately about the structure and activities of the company as well as about the duties and responsibilities of supervisory boards?	Yes [] No []	Yes [] No []	
	Does the Supervisory Board (excluding employee representatives) have a majority of the company and its board of independent members?	Yes [] No []	Yes [] No []	
	Has the Supervisory Board defined criteria for independence and published it in the Corporate Governance Report?	Yes [] No []	Yes [] No []	
	Are the independent members listed in the Corporate Governance Report?	Yes [] No []	Yes [] No []	
	In the case of a free float of more than 20%: Is there at least one independent member who is also not a shareholder with more than 10% or represents the interests of such a shareholder? In the case of a free float of more than 50%: Are there at least two independent members, who are also not shareholders with more than 10% or represent the interests of such a shareholder?	Yes [] No []	Yes [] No []	
	Does the Corporate Governance Report show which members of the Supervisory Board meet these criteria?	Yes [] No []	Yes [] No []	
	Do not a total of four Supervisory Board mandates (chairmanship counts twice) in the Group's stock corporations have members of the Supervisory Board who are members of the Management Board of a listed company?	Yes [] No []	Yes [] No []	
	Are the chairpersons and deputy chairmen, as well as the name, year of birth, the year of the first appointment of each member of the Supervisory Board, and the end of the current functional period, in the Corporate Governance Report?	Yes [] No []	Yes [] No []	
	Are the other Supervisory Board mandates or comparable functions in domestic and foreign listed companies disclosed for each member of the Supervisory Board in the Corporate Governance Report or on the website?	Yes [] No []	Yes [] No []	
	Are the absences of individual members of the Supervisory Board noted in more than half of the meetings in the Corporate Governance Report?	Yes [] No []	Yes [] No []	
	Has the Corporate Governance Report issued a declaration of compliance with the Austrian Corporate Governance Code (commitment to the Code)?	Yes [] No []	Yes [] No []	
	Was the Corporate Governance Report published on the Company's website?	Yes [] No []	Yes [] No []	
	Was this site reported in the management report?	Yes []	Yes []	

		No []	No []	
	Has compliance with the rules of the Code been evaluated regularly, but at least every three years by an external institution, and reported in the Corporate Governance Report?	Yes [] No []	Yes [] No []	
	If, as far as the company is known, the current shareholder structure, differentiated by geographic origin and type of investment, cross-shareholdings, the existence of syndicate agreements, restrictions on voting rights, registered shares and related rights and restrictions were disclosed on the website and in the annual report?	Yes [] No []	Yes [] No []	
	Have the current voting rights been posted on the website?	Yes [] No []	Yes [] No []	
	Were the articles published on the website?	Yes [] No []	Yes [] No []	
	Were the quarterly reports prepared in accordance with International Financial Reporting Standards (IAS 34)	Yes [] No []	Yes [] No []	
	Have major deviations from previously published objectives been explained during the year as part of regular publicity?	Yes [] No []	Yes [] No []	
	Were all capital market-relevant information from presentations and analysts' conferences provided at the same time to all shareholders?	Yes [] No []	Yes [] No []	
	Were the reports also available in English?	Yes [] No []	Yes [] No []	
	Have the reports been made available on the company's website?	Yes [] No []	Yes [] No []	
	Were the company's annual financial statements made available?	Yes [] No []	Yes [] No []	
	Were the main risk management instruments used in the group management report described in relation to non-financial risks?	Yes [] No []	Yes [] No []	
	Has a contact person been established for investor relations and published with contact details on the Company's website?	Yes [] No []	Yes [] No []	
	Will the notices of Director's Dealings be published without delay on the company's website and remain there for a period of at least 3 months or has a link to the relevant website of the Financial Market Authority been set up on the Company's website?	Yes [] No []	Yes [] No []	
	Has a financial calendar been prepared for the coming financial year with content provided in the Code and published immediately on the Company's website at the latest two months before the start of the new financial year?	Yes [] No []	Yes [] No []	
	Is the contract for the implementation of the (Group) audit to be based on international auditing standards (IAS)	Yes [] No []	Yes [] No []	
	If the (group) auditor was invited to another meeting in addition to the cases provided for in the law, or if no more than two examinations were held, the group auditor was invited to attend both meetings.	Yes [] No []	Yes [] No []	
	Was this meeting also setting out how the communication between	Yes []	Yes []	

	the (Group) auditors and the Audit Committee has to be communicated?	No []	No []	
	Were there also opportunities for an exchange between the Audit Committee and (Group) auditors without the presence of the Management Board?	Yes [] No []	Yes [] No []	
	Has the auditor been invited, if necessary, to meetings of the Audit Committee?	Yes [] No []	Yes [] No []	
	After the consolidated financial statements have been audited, the Executive Board has presented the Supervisory Board with a list of the total expenses for the audits in all Group companies, separately for the auditors of the consolidated financial statements, members of the network to which the group auditors are members Active auditors.	Yes [] No []	Yes [] No []	
	Has the auditor reported on the operational capability of risk management to the Executive Board?	Yes [] No []	Yes [] No []	
	Was this report brought to the attention of the Chairman of the Supervisory Board?	Yes [] No []	Yes [] No []	
	Has this been dealt with in the Audit Committee and reported to the Supervisory Board?	Yes [] No []	Yes [] No []	

As we can see, this questionnaire is a perfect example of the type of instrument currently being used for evaluating board performance. The focus -as is it is usually the case- is on the functioning of the board, its processes, its committees and so forth. It is a one-size-fits-all type of questionnaire that mostly serves to emphasize the compliance function of the board. It asks about important questions regarding processes, the functioning of committees, conflicts of interest and so forth. But it totally excludes the specific situation of the company, its strategic goals, and the ways the board is contributing to the achievement of the said goals. It does not set any objectives, thus board performance cannot be evaluated and quantified and no action plans can be established.

In summary the reality of board assessments, as explained by reports, surveys and the actual practice of companies themselves show there has been progress towards better good governance practices. Increasingly boards are taking more responsibility and even some accountability. Separation between board chairman and CEO is increasing, diversity too, board training is being implemented by pioneering companies, board evaluations are a common occurrence today. However, they are not achieving their purpose, which is to improve companies' performance and create long-term value for all

stakeholders involved.

Having reviewed in this chapter the current evaluation practices, the following one, chapter V is dedicated to the analysis of their effectiveness. The difficulties encountered will be reviewed as well as the design of various types of evaluations to conclude with a section on the shortcomings of evaluations currently being performed.

V. Effectiveness of Current Evaluation Practices

Having reviewed in the previous chapter the present reality of current evaluation practices and what companies are doing in this respect, in the real world. This chapter adopts a more theoretical focus centered on literature contributions.

In the first place, it discusses the practical difficulties to implement board evaluations, chief among them, the reluctance of board of directors themselves. Difficulties also include the ambivalence about the usefulness of the practice itself, the lack of appropriate information, the lack of guidance from regulators and so forth.

It then goes on to present some examples of effective board assessments cited by literature, which include: Amoco, Motorola and the Montreal Bank. The chapter's third section presents the different methods recommended by literature and their corresponding characteristics. It emphasizes the need to set a clear objective for the evaluation and to combine quantitative and qualitative aspects, both aspects emphasized by almost by all researchers. It also explains the three main techniques: self-evaluation, peer evaluation and the use of third parties, describes the limits of both quantitative and qualitative techniques and explains the board maturity model, a concept developed by Beck and Watson in 2011.

The fourth section of the chapter insists on the impossibility of evaluating the board in an objective manner without clearly set objectives, through the points of view of the Australian Corporate Governance Council regarding board competences, and the concept of the "fit for purpose" board developed by Beck and Fibich in 2015.

Finally, the last section reviews the shortcomings of current evaluation practices. It concludes that board assessments in their various present forms fail to address the crucial question of how and to what extent do boards contribute to achieve the performance goals of the companies they serve, which indeed constitutes the essence of boards' purpose and function.

Evaluation difficulties

By the end of the 1990s, the subject of corporate evaluation was already being discussed in literature and companies were starting to pay some attention. Conger and Lawler III (1998) pointed out that the number of public companies adopting formal board evaluations was increasing as a result of higher regulatory pressure. However, boardroom appraisals were not widespread and very few companies were undertaking individual board members evaluations. According to a survey of directors from the Fortune 1000 companies, only 25% of the biggest US companies evaluated board performance at the time, even though a full 70% followed a formal protocol to evaluate the corporations' CEOs. And a mere 16% of the companies from the survey had formal evaluations of individual directors in place, making the subject even more prone to cause substantial debate and controversy (Conger and Lawler III, 1998).

The tick in the box exercise. Formal board evaluations are not a panacea if companies just execute a box ticking exercise to comply with demands of institutional investors. The authors (Conger and Lawler III, 1998) even note the testimony of a chairman whose corporation had recently adopted a board evaluation process and he admitted that he did not believe it was important to corporate governance. In his words, "*It's just that people conduct best-practice surveys of corporate governance, and we wanted to have the evaluations on our checklist*" (Conger and Lawler III, 1998: 139).

The situation was still quite similar in 2014, when PwC Annual Corporate Directors Survey reported that a considerable percentage of boards limited the evaluation process to a simple "check the box" exercise without giving the questions much thought.

Besides, formal evaluations do not spare companies who do take them seriously from having trouble, as proved by the examples of Texaco and Walt Disney. Texaco, for instance, had adopted best practices for corporate governance principles, in general, and board evaluations, specifically. However, its leadership and sound implantation of healthy corporate governance practices did not prevent negative publicity and serious internal issues around a corporate racism suit that was settled for $176 Million in 1996 (Conger and Lawler III, 1998; LA Times, 1996).

The Walt Disney Company has delivered extraordinary returns on investments to their shareholders over the years under the leadership of Michael Eisner. Nevertheless, the corporation has been repeatedly criticized for poor corporate governance standards, faulty and outdated procedures, as well as a flawed poorly performing board (Conger and Lawler III; 1998).

ACCA (Association of Chartered Certified Accountants) in 2012 insisted on the same idea. Their report points out that despite the fact that effective corporate governance relies to some extent on law compliance, full compliance does not necessarily translate into good corporate governance practices. An example of this miscorrelation is the bankruptcy of the large publishing company, Maxwell Communications PLC, occurred right after the release of the Cadbury Report in UK. The collapse was caused, among other factors, by an excessive concentration of power and the company borrowing from its pension fund (which was legal at the time) in order to achieve leveraged growth.

Board reluctance. Despite the increasing attention to board evaluations in corporate governance literature and the global dissemination of corporate governance guidelines and codes of best practice, boards have generally been reluctant to follow such recommendations. Ingley and van der Walt (2002) contends that although the use and need for formal evaluations is widely recognized, in practice there is a general resistance to formally institute the process. The question about potential reasons for such resistance comes to mind given the background of the missing information exchange and information flow that would highlight the relevance of a board assessment. Given the questions in this context, the phenomenon of reluctant directors and boards that do not readily undertake performance reviews in a formal way has been discussed and widely debated in an effort to find potential solutions and explanations. Being an active participant in these discussions over the need for an evaluation of individual board members and directors, Tricker (1999) takes a decidedly favorable stance toward the idea of individual director evaluation. He further contends that stark contrasts and important differences exist between the English-speaking countries he was studying. Britain, for instance, has a corporate culture that tends to neglect and consider as inappropriate practices that concentrate on individual assessments of board directors. This conception is grounded in the British seeing their boards generally as a team that has to function as a whole and depends on the individual contributions of the board

directors that all come with a set of skills and significant experience that are beneficial to problems and issues that are topics of discussion at the board in a given situation and context (Researchgate.net, 2002).

Other scholars have different viewpoints about why there is so much resistance to evaluate the board of directors in certain circumstances. Kazanjian (2000), for example, highlights the aspect of processes and regulations that govern board evaluations as roadblocks that undermine the possibility of getting to the gist of potential problems that exist on boards of directors. The official form of evaluations does not effectively afford any progress but are just forms and rituals kept for compliance reasons in his opinion. At the same time, however, Kazanjian (2000) also mentions that alternatives to self-evaluations of boards of directors are possible, such as formal regulations, rules and perhaps even corporate laws that clearly limit decisions that are made in a corporation and provide guidance for business judgements made by corporate personnel. Moreover, in the context of the new type of economy and the new type of companies that emerge from it, it is questionable to what extent these types of evaluations might be applicable to boards of directors of the new economy. Evaluating board performance may seem pointless or irrelevant compared to more pressing issues, such as falling share prices or funding rounds.

Another reason that Kazanjian (2000) suggests refers to the uneasy and uncomfortable feeling that directors might experience from being evaluated in an assessment of the board. Some directors may feel uneasy and uncomfortable with receiving a rating or being required to give a rating to others. This may be the case particularly for senior directors and members of the board who are perceiving their seniority as a reason for not having to be subject to any evaluation or assessment out of respect for their experience and history with the board, even though individuals serving on boards of directors tend to be used to assessments of this type from other functions and responsibilities. An exception to this is the yearly review of the directors by the shareholders who may or may not choose to elect the board members again.

Another scholar who agrees with this perspective is Steinberg (2000), who confirms the argument that directors that serve on boards are very senior people that may have not received an evaluation in several years and therefore are less likely to embrace it positively. One may even suppose that directors and board members who have not

received formal training in leadership or directing of a board are afraid of situations in which these shortcomings might be revealed and put them in uneasy situations (Garratt, 1997).

From a more general perspective, it can be stated that an effectively executed assessment of the board and its processes can put several obligatory conditions that relate to corporate governance to a test with high potential (Kazanjian, 2000). From a normative perspective, this stress test is desirable since it could reveal problems relating to board roles and division of responsibilities in the group of directors, assessment and evaluation standards, roles, training of the board, selection and administrative processes, as well as responsibilities and management's expectations for the board in its entirety and directors in their individual functions. However, one also should raise the question as to whether it makes sense in the particular situation of the board to expose the board to the risk of potentially facing internal tumults and stress due to uncovering potential problems induced by an evaluation.

In general, it is always good to reveal problems and induce positive, constructive criticism through effective evaluation, even if it is discomforting for the board members and sensitive issues are revealed that can relate to poor board or individual board member performance, incompetence and so forth. The timing must be right and should not coincide with major obstacles that an organization is facing in a given moment. Once encountered though, issues cannot and must not be ignored and should be tackled and dealt with accordingly.

Board reluctance to evaluation processes can also be rooted in the concern about a disruptive impact on the group dynamics within the board, potentially leading to less amicable relationships; open communication and complete honesty could also be undermined. Of course, the reliability and the validity of the assessment also has to be carefully analyzed before any conclusions that are drawn can be extrapolated to achieve improvements. The mere fact that the assessments could contain faulty data due to the fact that after all they are collected in a somewhat unnaturally induced manner often plays a role (Kazanjian, 2000).

These somewhat unnaturally created environments in which directors are supposed to be assessed could also keep board members to refrain from asking questions in the

plenum with the entire board present since they could think that it may have negative repercussions on their own evaluation (Kazanjian, 2000). From a perspective that does not start at the individual director level, this could also mean that traditional ways of evaluation, such as interviews, surveys and questionnaires are not powerful enough to capture the full range of contributions that directors are providing for their companies.

Perhaps indicators used to assess board's and director's performance have been overly simplistic and approaches to evaluation may have been relatively unsophisticated in their understanding of the type of evaluation being carried out, the dynamics involved, and how it contributes to board effectiveness. It is thus important to consider what is being measured, who is doing the measuring, and how it is conducted

Perhaps this resistance causes an oversimplification of indicators used in board and individual director assessments. The type of assessment, dynamics at play during and after an evaluation, and its net impact in terms of how much the evaluation actually contributes to board effectiveness, all of these seem to be treated in a rather unsophisticated fashion. Hence, it is crucial to be aware of subject, conductor and way of execution regarding the measurement in order to reach differentiated, objective conclusions (Ingley and van der Walt, 2002).

It is also not easy for boards to undertake self-evaluations because it implies making judgments and decisions about themselves (Conger and Lawler III, 1998). And more than 15 years later, the PwC 2014 Annual Corporate Directors Survey noted that most boards reported difficulty to be frank in evaluating the board.

Ambivalence regarding the nature and worth of board evaluations. In their exploratory research, Ingley and van der Walt (2002) report that an uneasy and ambivalent feeling persists in directors and members of the board from all over the world about the way board evaluations are being conducted and how much value they can add.

A particular concern noted by research in New Zealand is about boards of directors assessing individual board members and their contributions -is it actually accurate and meaningful in the broader context of the organization and the environment it operates

in?

Moreover, evaluation results and the corresponding process are perceived by many directors to potentially have a negative, counterproductive effect on the interpersonal relationships and group dynamics within the board that could undermine stability and productivity.

These considerations lead to some important thoughts implied in the uneasy and uncertain connotation that board evaluations have in the minds of many board members. First, given the importance of the interpersonal dimension in board room settings, it would be important to investigate the ramifications and implications of methodological differences regarding endorsements and appraisals. Secondly, the way in which board assessments and its outcomes are applied is an important topic to look at in this context against the backdrop of the wide range of activities a board is undertaking on a constantly evolving basis. Thirdly, it is important to assess the link between the influence on activities performed by the members of the board and when/how changes to its effectiveness take place as a result of the endorsements and appraisals that were conducted.

Some amount of confusion continues to exist among most directors about relationships between board evaluations and topics such as compliance, organizational performance and the performance of the board of directors in general. In this context, if the compliance aspect of corporate governance is prioritized and accorded higher weight than the element of performance improvement, the result is likely to be perceived as counterproductive and certainly not as a way of improving board effectiveness. This could give rise to an underlying negative bias and a non-favorable image of board evaluations. Besides, confidence in the meaningfulness and validity of board evaluations is not much helped by the fact that complexly intertwined issues around board performance and effectiveness are often assessed by means of rather simple and plain evaluation methods.

Such simple evaluation methods are determined by the easiness of measuring and also by the rather descriptive, simplistic and obvious elements of corporate governance. The latter include such aspects as the number of outside directors relative to the number of inside directors, meeting attendance, number of hours each director devotes to his or her

board work relative to other responsibilities, board diversity, or the number of directors that are simultaneously shareholders. This is frequently echoed in arguments that criticize check-list assessments and similar types of evaluations as a mere reinforcement of the structures and practices that are already in place. However, the real goal of board evaluations should be effective and objective measuring that seeks to constructively investigate business acumen, the ethical dimensions as well as strategy focus and skills of the board and the organization (Kazanjian, 2000; Staff, 2000; Van der Walt & Ingley, 2001).

In this context, Ingley and van der Walt (2002) contend that the tendentially more subjective areas of study that relate to the effectiveness of the board have to be understood in a more nuanced and in-depth way. At the same time, it is important to note that power relationships, political dimension as well as group dynamics and group behavior are highly relevant and useful elements to take into account when designing and devising a sound board evaluation; particularly when dynamics and patterns are not that obvious and perhaps even intentionally kept concealed by board members.

The ambivalence that surfaces in evaluations and the ambivalent feeling regarding the nature, worth and meaningfulness of board evaluations highlight the urgent need for sound and understandable evaluations that make sense to and are accessible by people involved in them. Directors should be explained the actual purpose of the board assessment and how its results can be used to achieve improved performance and better board dynamics in general. Furthermore, compliance can be ensured, which is of interest to each director and the organization.

In sum, if regular formal reviews are presented as ways to ensure cooperation and enhanced effectiveness of the board members, they may be more prone and willing to accept and embrace board assessments on a regular basis. A public and organizational acceptance and confidence regarding the purpose and validity of board evaluation processes would result in more acceptances. It could turn into a positive factor in the reporting of an organization that communicates value and progress; more so, if information regarding the evaluation process and its results are shared with the public.

Incompleteness and lack of appropriate information. Most board appraisals conducted by companies that were pioneers in boardroom evaluations were incomplete. They failed to measure the adequacy of important board resources and capabilities, or to set clear performance objectives (Conger, Finegold and Lawler III 1998).

The authors also point out that most companies miss an essential element in board evaluations −the data obtained from outside the corporation. In fact, they usually base their evaluation processes on information solely derived from internal sources. This may cause distortions in the view of the company´s competitive or financial position. External information can be extracted from institutional investors, market analysts, regulatory bodies, the press and academic journals; it is also probably useful to compare board performance against competitors. Institutional investors, in particular, are usually keen on providing their views on board performance.

Both internal and external sources must supply members of the board with the required data and information. This should include, but not be limited to:

- Detailed meeting reports with an analysis of how much time was spent by the various participants on what subjects.
- The activities each board member was involved in throughout the year, and how those actually contributed to advancing or improving each category of the yearly objectives.
- Description of specific achievements. And, if applicable, the description of behaviors that facilitated a particular achievement by a board member or the board as a whole.

Board members practicing the aforementioned methods should be able to define and keep a list of specific action items related to issues and topics that were addressed during the recurrent meetings throughout the year. The list should be organized according to priorities, time spent on each individual topic, date of discussion, participants and owners of actions. Subsequently, each item on the list should be related to tangible outcomes and beneficial improvements, regarding board or company as a whole, that can be directly attributed to specific activities or actions taken as noted on

the list. In this manner, activities and initiatives such as opening new sales offices in Shanghai and Beijing and monitoring overall sales figures and sales development in the region should be checked against the objective of expanding a company's scope and market share in China and then linked to specific practices and actions discussed during board meetings (Conger, Finegold and Lawler III 1998).

Execution is key. The appropriate execution of the board evaluation is a driving factor of its success. Resources available to the board during the evaluation process should be examined in view of the objectives set at the beginning by the board members regarding performance indicators of board effectiveness. According to some specialist in the field (Conger, Finegold and Lawler III 1998) the review should ideally be conducted by a suitable outsider to the organization, for example, the corporate counsel, a director that plays a leadership role within the board, or the evaluation chair that oversees the overall process. It should be done confidentially and comply with ethical guidelines. According to the authors, the best method to conduct such a review is a survey consisting of a combination between standardized multiple-choice questions that can be scored numerically and open questions that leave more room for explanatory answers. It is important that the questions remain the same over time in order to be able to compare results from year to year and thereby being able to track and comparatively assess performance of the board throughout the years.

Need to adapt the evaluation process over time. Other factor to have in mind to assure the effectiveness of the board appraisal process is to continually review it and keep it updated to the current needs of the company. Otherwise, instead of being a meaningful opportunity for feedback and debate, evaluations can turn into a rote process of mere compliance. In addition, if the same evaluation issues are invariably repeated over time, boards miss the possibility to cover new areas that need to be addressed. (Conger & Lawler III, 1998).

Holly Gregory (2015) points out that in corporate governance there is usually a strong presumption that each board member will be re-appointed the following year. This is the reason why any change in board composition is mainly due to a director reaching the age limit or deciding to no longer serve. In general, board composition is not assessed rigorously enough regarding changing business needs. Board evaluation is

meant to tackle this shortcoming and help boards to self-improve.

Gregory contends that to make the evaluation process productive and to capitalize on its outcomes, it is essential to avoid a rote compliance-focused approach. Moreover, the approach and methodology have to be adjusted and renewed from time to time to keep the evaluation meaningful and to pursue performance enhancement.

Lack of guidance from regulators. Phyllis Deiso (2014) explains that there is no current universal legislation that requires regular board assessments for all public companies. Nevertheless, board evaluations are mandatory for all companies listed in the New York Stock Exchange and they are a voluntary option in companies listed in NASDAQ. NASDAQ companies undertaking board evaluations have the opportunity to get ahead of the curve and position themselves in the vanguard of good governance.

However, there is little direct guidance from regulators on the best way to conduct board evaluations. Indeed, there are still a big proportion of boards who do not take the evaluation practice seriously, since there are no specific rules to be applied. A comprehensive and rigorous board evaluation requires time and effort. Moreover, the process to evaluate board members can generate an uncomfortable and tense environment in the boardroom.

Board dynamics not taken into account. Beck and Fibich (2013) contend that, despite the increased use of board evaluations as a method of performance improvement and the external pressure from regulatory prescriptions or recommendations to make evaluations more formalized and rigorous, boards undertaking them are not actually improving. This may be due to the fact that the appraisals are not deeply conducted to assess the way a board operates, the skills it needs and the potential effects of different persons and their behaviors on board effectiveness. In the authors view: "*... a board can have all the policies and procedures in place for good governance, but if the dynamics around the boardroom table are poisonous, the outcomes will be poor board performance, often contaminating organizational performance. For example, a dominant personality on the board can inhibit contributions from other directors.*" (Beck and Fibich, 2013: 592)

Furthermore, the authors point out that corporate failures share a common problem of poor board behavioral dynamics −a culture where disagreement is repressed and loyalty is measured by agreement rather than dissent.

In the authors' view, evaluations should assess three different levels of board effectiveness: the organizational level, the group level and the individual level. The first level deals with analyzing the board purpose, because only with its fulfillment the board can contribute at the organizational level. Later, evaluations should also consider the group and individual level of analysis, since the personal traits of a director influence his/her capacity to contribute to the board in different ways.

What is needed is a more elaborate, sophisticated way of approaching the effectiveness and comprehensiveness of evaluation methods. Substantial improvements in this regard can only be achieved, according to Staff (2000), if relational factors -that have the tendency to be more subjective in nature- are included in the evaluation process. Such factors, typically characterized by a smaller degree of objectivity, include the selection of directors, measuring the value individual directors have created or contributed to the board and/or the organization, as well as teamwork and interpersonal skill levels of board members. Hence, the appraisal model should contain not only process and function as essential elements, but also interpersonal and relational dynamics as well as individual competence and skill levels. Although it is true that these subjective, behavioral and interpersonal factors are hard to quantify and index in a quantitative manner, their inclusion in the holistic investigation of the effectiveness of a group of directors is often crucial to gaining a sound, differentiated understanding and, eventually, being able to adequately evaluate the board of directors to the benefit of all stakeholders.

Effective evaluation examples cited by literature

Conger, Finegold and Lawler III (1998) highlight the effectiveness of **Amoco** Corporation and **Motorola** board evaluation approaches, both of them based on a questionnaire. Motorola uses a survey which includes 27 multiple-choice questions such as: "*The board of directors is prepared to deal with unforeseen corporate crises*." and 7 open-ended questions, such as: "*Does the board have an appropriate mix of overview and approval activities? If not, what should be different*?"

The **Amoco** questionnaire consists of six categories and asks directors to evaluate board's performance in each of these categories as "excellent," "satisfactory," or "needs improvement" and it includes a blank space for comments. The survey ends with two open-ended questions asking directors how they would rate the board's overall performance and requesting improvement suggestions.

Other companies base their board evaluation on individual interviews with each director undertaken by the nominating, governance or compensation committees. The interviews can be face to face or by telephone using open-ended questions.

The committee responsible for corporate governance should analyze the evaluation information, compile the results into a single report, determine whether the objectives were met and identify improvement areas. Lastly, the outcomes are presented to the board in a summarized form; the board then discusses the areas to be improved and creates an action plan.

Aside from the content, the tone and delivery style of the presentation to the board is of uttermost importance as well. A good balance between praising positive outcomes and highlighting divergent perspectives is crucial to the successful and effective delivery of the presentation. Anonymity of all involved must be preserved at all times unless a specific individual requests or consents to his or her name being mentioned to prove a point or present an example. Other elements of effective board presentations include trust and rapport, active listening and respectful discussion. Presenters who effectively create presentational circumstances along the lines of these building blocks will be perceived as independent from senior management and CEO, which is an important condition for objective communication and reception of the presentation material. One option is the appointment of a lead director, and in lieu of such a role previously appointed by the board, an outside director should be appointed leader of the committee in charge of corporate governance.

Several advantages come with giving positive feedback and appraisal in this manner. To begin with, board members can rate themselves objectively with the help of the scores on the questionnaire papers, keeping in mind a number of important dimensions. An exchange of knowledge among directors about individual viewpoints and in what ways those might differ is an additional advantage.

A fruitful addition to these advantageous practices comes from Ingley and Van der Walt (2002), who propose to have an independent expert in the field of group dynamics and processes present at board meetings. Such an expert's presence could yield valuable insights into how board performance might be improved and what forces are at play that might need reconsideration. Having no personal or otherwise biased interest in the outcome of the meeting, the expert can furthermore hint at potentially dysfunctional group behaviors that hinder collaboration, if applicable, and enhance the flow of information to accelerate and optimize communication and outcome-oriented collaboration during meetings.

Other exemplary models of evaluation highlighted in literature are the ones developed by Hewlett-Packard and Compaq (Anonymous, 1997, 1998; Platt, 1997) and the **Montreal Bank** (Kazanjian, 2000). The corporate governance committee of the Montreal Bank conducts annual surveys with its directors regarding the subject of board and board committee effectiveness. Subjects covered by the survey include structure of the board, board operations, meeting agendas, information given to directors and accuracy of the said information, effectiveness of the board committees and the lead director, the strategic plan and processes of the board.

A director peer review survey is conducted by the corporate governance committee for each director currently serving on the board and having been a board member for more than 18 months. Among other things, performance against the Charter of Expectations for Directors is measured in terms of concrete issues. These include insight into strategy, business judgment and accountability, financial literacy, as well as participatory and communicative activities of the board members.

Subsequently, an outside firm analyzes and assesses the survey results, thereby getting also involved in the process of measuring. This process results in personalized reports for each individual director with the corresponding scores, performance review summaries and analysis and review of the corporate governance committee functioning and structure. Finally, recommendations are made by the committee about adjustments to processes, practices and procedures in place, striving to make an informed decision and judgment based on the survey results and in the best interest of the board and its functional role (Kazanjian, 2000).

Design and customization of board evaluation

The design of any board evaluation program requires discussion with the board regarding the structure, feedback and follow-up of the assessment. The evaluation system demands the board's buy-in to ensure that it will be actually implemented and used (Stybel and Peabody, 2005). When it comes to the process of a complete board evaluation and its design elements, it is important to note that not a single design approach exists that would suit any given board. That is to say that the board evaluation process is a highly contextualized, specific sequence of personalized interventions. To maximize the impact and positive transformation potential of these interventions, the specific situation of the board of directors and the surrounding organization has to be taken into account and carefully assessed in advance. Only with such a tailored approach the board evaluation can reach the maximum level of effectiveness.

To achieve the optimally tailored and adequately individualized methodological approach to evaluating a particular board, a number of factors should be carefully taken into account. These factors include the organizational culture of the company, values, mission statements and, more generally, the internal operational and political dynamics of the group of directors who are responsible for corporate governance. Participation of all directors involved is crucial to the successful design and procedural execution of the evaluation. A sufficient level of such trustworthy and contributing participation can best be achieved by first developing a deep understanding of the aforementioned cultural and internal factors relevant to the particular company. By the same token, a significant amount of thought and attention should be given to the momentary situational context of the company regarding their internal and external developments, potentially ongoing changes, as well as needs and desires. For example, a situation in which a company is steady and has not faced significant changes in management, board members or strategic orientation regarding the key markets, positioning or other core business activities may require an entirely different evaluation design and corresponding process compared to a company that is in flux, facing a volatile market situation, fluctuating conditions or internal changes in management, board members or leadership (Cohn and Kess, Thacher & Bartlett LLP, 2016).

The Balanced Scorecard from NACD. Some firms in the USA use nationally accepted standards of self-evaluation such as the Balanced Scorecard from the National Association of Corporate Directors (NACD). The Balanced Scorecard provides a large performance measurement framework for board self-evaluation. This system can be awkward to administer and does not adequately distinguish management from governance.

The standards put forward by the NACD cover an all-encompassing range of topics that can be used by all types of industries and companies. They are suitable to effectively manage risk and safeguard fruitful evaluation practices. More specifically the NACD considers the following elements as key for board effectiveness:

- *Right People: People are the primary building block. A board composed of the wrong people will be ineffective and largely under serve the firm. While the company can perform well under such an arrangement, the shareholders would rely too much on management skills.*
- *Right Culture: If the board does not have an open, trusting environment that inspires and celebrates active, spirited debate, no further progress can be made.*
- *Right Issues: If a board has the right people and the right culture, but focuses on the wrong issues, the board cannot add shareholder value, the main objective of a board.*
- *Right Information: As the board identifies its key issues, it will know what further information it must seek.*
- *Right Process: Having the right people, culture, issues, and information goes a long way. However, the board needs the right process to evaluate and refine its performance in all these areas.*
- *Right Follow-Through: The term "follow-through" is shorthand for the right spirit*

of accountability and continuous improvement. Nothing is static; boards can always improve. An effective board seeks accountability and continuous improvement from whatever rigorous assessment it adopts".

(Source: Report of the NACD Blue Ribbon Commission on Board Evaluation. 2015 Report)

Nevertheless, and despite the merits and numerous benefits of the NACD standard, adhering to and respecting it too strictly can result in an extremely time-consuming, potentially tedious process that puts a strain on the board members and their patience. Used excessively or in the wrong manner, board anger and frustration can be the result instead of the desired enlightenment and progress. Customization and personalization of various aspects of this general tool helps to mitigate those risks of poor usage and inefficiencies. These alterations and adjustments, however, should only be made in well-researched and well-informed situations, in consultation with an expert that is an outsider to the organization in question; to prevent any unwanted problems with this self-evaluation tool.

Regarding the practical part of the survey, it is important to carefully design the process of actually administering the survey on an online platform or, more conventionally, on paper. If the choice is made for alternatives, such as personal interviews or focus groups, the way of administering the survey has to be adapted accordingly. A person has to be appointed to lead the intervention using the survey questions as a guide on the phone, via Skype or in person. Subsequently, a tabulated version of the results compiled by the person leading the data collection process is then presented to the board at a designated meeting and accordingly discussed to understand the data's significance and implications.

It is critical to have clear guidelines and to adhere to the highest standards of data protection, retention and confidentiality throughout the whole process, since only if those conditions are met and the board feels comfortable with them, true and valid answers will be obtained from board members. Only those genuine answers can bring the desired quality of data and answers that will yield insight into what is going on within the board of directors.

Need for a systematic and comprehensive approach. Literature and academics have broadly recognized the need for a more systematic and comprehensive approach to board performance appraisal. Despite the proliferation of corporate governance codes, requirements from stock exchanges and regulators, there has been a lack of theoretical and practical approach to the features of board evaluations (Conger et al., 1998; Ingley and van Der Walt, 2002).

Performance evaluation systems (PES) are used regularly by companies to monitor or improve corporate or individual performance (Marie-Joseé Roy 2015). Empirical evidence supports the fact that performance evaluation systems improve corporate performance and bring about beneficial financial outcomes, improved customer satisfaction and higher employee retention (Aguinis and Pierce, 2008; de Waal and Counet, 2009). Nevertheless, authors such as Marie-Joseé Roy (2015) claim that there are great difficulties in designing and implementing these systems effectively. In practice, most performance assessments are poorly and subjectively executed.

In addition, individuals of higher position in the organization, who often perform unstructured and ambiguous tasks, are the least examined. They receive infrequent and superficial reviews which cannot give a comprehensive picture of their performance. This is known as “the paradox of executive appraisal”, signaling that executive appraisal processes are rarely and arbitrarily done. Moreover, the subjacent reasons to conduct evaluations are based on fallacious assumptions or myths about the nature of the executive and their work (Logenecker and Gioia, 1992). This uncertainty is said to make it more difficult to effectively capture the actual performance of these executives (Marie-Joseé Roy 2015).

Determining targets, improvement measures and the output of board evaluations. These three elements are essential to achieve an effective evaluation process both for board and company improvement (Roy, 2008; Dulewicz and Hebert, 2008; Northcott & Smith, 2011). Despite their importance, these three elements are typically left out of most boards' evaluation processes, which rudimentarily reduce the equation to merely identifying what should be examined regarding board performance, lacking target, measure and output.

These shortcomings in evaluation procedures are usually caused by three main

concerns:

- Dissatisfaction and/or frustration of key stakeholders with inadequate problem resolution by the board (Long, 2006).
- Corporations' fear of legal or civil repercussions, as a result of improper board conducts surfacing during board evaluations (Stybel and Peabody, 2005).
- The highly complex, time-consuming and tedious nature of a board evaluation.

Contribution of board evaluations. Ingley and van der Walt (2002) contend that there is a general controversy in governance literature regarding the purpose, value and contribution of board appraisals to board effectiveness. The main reason for this disagreement lies in the politics of “horizontal” evaluation of board peers – in contrast with the vertical appraisal implied in management appraisals. In addition, there is a level of discomfort among board members when addressing more subjective issues of boardroom dynamics or relationships between individuals. Nevertheless, the authors contend that subjective measures in board evaluation are critical in assessing board effectiveness.

Qualitative and quantitative evaluation techniques. According to Kiel & Nicholson (2005) depending on the formality, the objectives of the evaluation and the resources available, there are a broad variety of quantitative and qualitative techniques to be used in the evaluation. Quantitative research methods include questions of how much and how many. While qualitative research methods use questions of “what”, “how”, “why”, “when” and “where”.

Techniques for collecting qualitative data are often used when the goal of the evaluation is to identify the source of a governance problem and come out with possible solutions or new approaches. Qualitative data is also suitable when the objective of the evaluation is to understand the board members views on a particular subject.

The use of qualitative data implies some risks, as the person in charge of interpreting the results has to make judgments. Therefore, the results of the evaluation can be subject to bias and be open to criticism, especially if the interpreter is a member of the board or the company. To avoid bias and prejudices, Kiel & Nicholson recommend the use of

specialized researchers to perform the appraisal and that many participants check the results. The combination of quantitative and qualitative techniques is another solution to improve objectivity.

The three main techniques of qualitative research. These include interviews, board observation and governance documentation such as board papers analysis. Interview is the qualitative method by excellence that –if professionally designed− provides the opportunity to collect complex and rich data. It addresses directors' perceptions and constructions of reality by allowing them to express themselves in their own terms.

Individual interviews. These are the most common ones as they allow the disclosure of sensitive issues within a confidential environment. They are a suitable technique for individual director assessment since they allow directors to address one or two main issues in-depth. In general, and through open-ended discussions, they constitute a much richer source of information than quantitative techniques (Kiel & Nicholson 2005; Conger et al., 2001).

Collective interviews. Here, an interviewer acts as a mediator or facilitator of a discussion involving a group of several people. The key benefits are that it consumes fewer resources and it provides data and insights only reachable through group interaction. However, Kiel and Nicholson (2005) recommend avoiding this method when there are sensitive issues in board interpersonal relations and dynamics.

Observation is a qualitative technique used in board meetings, where a researcher observes a group of participants simultaneously and without intervening. In fact, the researcher does not ask any question neither manipulates nor influences the participants, but rather takes note of their behaviors, activities and points of interest to the research goals. This technique is used to analyze boardroom culture and dynamics, and interpersonal interactions. Since it collects data of the events that actually occurred in the meeting, it is free of directors' bias. However, as it reflects the view of the observer, it may be somewhat subjective.

Kiel and Nicholson (2005) report that observation tends to be highly effective in situations when the objectives of the evaluation stand in direct correlation to boardroom dynamics, for issues of board functioning or interactional relations among individual board members. The observer has a particularly powerful position and through careful observation can achieve a number of useful insights, including, but not limited to, the following:

- Relationships and ways of relating to one another among board members.
- Salient, dominant individuals (and their respective contributions, or lack thereof) during discussions.
- The leadership potential and the realization and adequate fulfillment of the chairperson's leadership role.
- Potential tensions between board members.
- The effectiveness and practicality of the agenda during meetings.

The observation material and the passively gained insights into the workings of the board are particularly valuable when combined with information actively obtained from directors in personal one-to-one conversations (Kiel & Nicholson, 2005).

Lastly, the use of contemporary and historical information from the company can be a complementary method to use in conjunction with other data collection. Board papers such as board minutes, policy manuals and governance charters can give a valuable insight into the governance system and other data collection systems. The advantages of this method are the questions it raises such as: "*Why does a particular document not exist? What level of detail is included? What is recorded? What is omitted? What is the writer taking for granted?"* (Kiel & Nicholson, 2005: p. 625). An additional advantage of the use of documentation is that it can be benchmarked with that of other "best practice" boards.

Quantitative techniques on their part provide specific and measurable data. Since it reduces data or phenomena to numbers, it is not as rich and informative as qualitative analysis. However, it is easy to develop, to collect from a broad number of people and to benchmark. It is useful to compare boards' performance with other boards or over time. The evaluation techniques will vary according to the different issues the board needs to address, keeping the evaluation cycle updated and interesting.

Surveys, the most common quantitative technique. As it was already noticed in the subsection devoted to questionnaires, surveys are an important tool for gathering information. However, they measure individual subjective views on particular topics and thus are subject to participant bias.

Depending on the objective of the evaluation, the survey can quantitatively assess the qualitative results of interviews or it can be used as an independent tool. Kiel and Nicholson (2005: p. 625) propose seven steps for the survey-based evaluation process:

1. "*Specifying the objectives of the survey, in light of the evaluation's overall objectives.*
2. *Deciding the composition of the survey sample, that is, who will be asked to complete the survey? Is it intended just for board members, or will others, such as the senior management team and the CEO, or external stakeholders be involved?*
3. *Determining how the survey will be administered. A common way to administer the survey is face-to-face, in a situation where the survey is just one part of evaluating the board's performance. Survey data can also be collected by phone, fax or email, or via the internet, which means that directors can complete them at a time and place suitable for them.*
4. *Designing the questionnaire. Excellent surveys support the purpose of the evaluation –the topics chosen are relevant to the evaluation requirements, the questions are worded in such a way as to gain the maximum relevant information and to avoid bias, and the measurement technique chosen is most appropriate for the information being sought (Kraut, 1996).*
5. *Administering the questionnaire. This involves the fieldwork necessary to under-take the board survey, including advising participants of the time and place for the meeting (if a group survey is being conducted), scheduling appointments (for individual surveys) or sending the questionnaires by mail, fax or email (as an attachment).*
6. *The coding and analysis stage of the survey process transforms raw data (the recorded measures in the responses) into information that can be used for decision making.*
7. *Presentation of the results. Once the coded data have been entered, it is a simple process to generate histograms and other charts to present the data*".

Good evaluations combine quantitative and qualitative. According to Deloitte (2014), the use of qualitative analysis can provide rich data and therefore more objectivity to the evaluation process. The Deloitte report describes the process as consisting of:

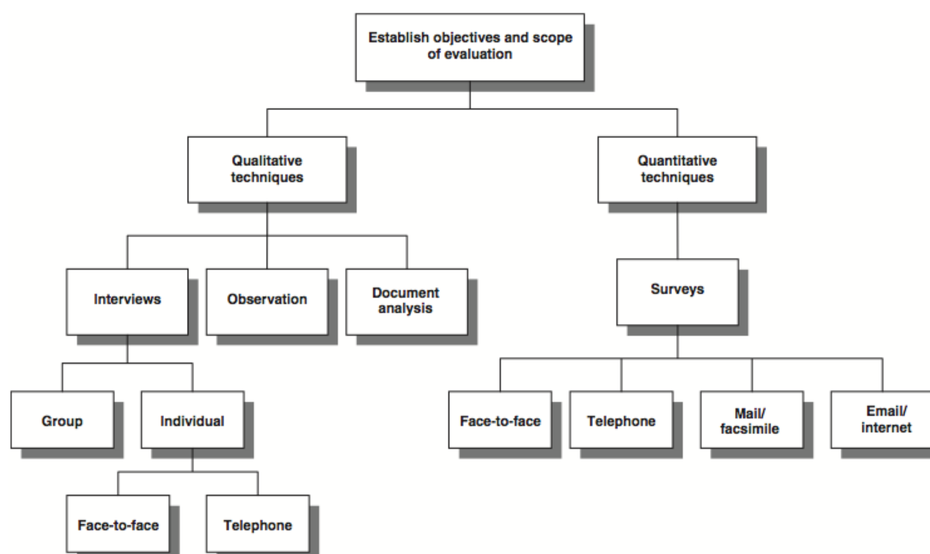
- Recognizing aspects to evaluate.
- Defining a questionnaire according to the evaluation areas.
- Attaining responses to the questionnaire from the individual directors in a grading scale.
- Interviewing individual directors and analyzing both responses, from the interviews and the questionnaires.
- Reporting the conclusions of the analysis to the board.

Finally, the board discusses the findings and creates an action plan to check it on a regular basis.

In sum, the election of the methodology will depend on the objectives of the evaluation and the board context. In designing the evaluation, the different advantages and disadvantages of each research technique must be taken into account.

As we have seen, all of the above-mentioned authors agree on the fact that a comprehensive and effective board appraisal should combine quantitative and qualitative methods.

Overview of the major qualitative and quantitative techniques used in board evaluations.



Source: Kiel C G, Nicholson G J. Evaluating Boards and Directors. Blackwell Publishing Ltd 2005. 9600 Garsington Road, Oxford, OX4 2DQ, UK and 350 Main Street, Malden, MA 02148, USA.

Self-evaluation, peer evaluation and the use of third parties.

Another factor to be considered in board assessment is whether to use self or peer individual director evaluations. Through self-evaluation directors reflect on their own contributions to the board performance and whether they have the required expertise. Nonetheless, self-evaluation is likely to lack an objective perspective of the boards' activity. On the contrary, peer evaluation is based on the collective input of other board members. It helps directors understand how they are perceived by their colleagues and can provide constructive feedback to improve individual and overall board effectiveness. It brings objectivity since it includes other perspectives about how directors are performing and it provides an overall view of the board functioning (Beck and Hamblin, 2007; Bohn and Davis, 2016).

Additionally, companies must determine whether to facilitate the evaluation internally or to use a third party and which of these approaches would be more effective and suitable for the company and the board (Cohn, Kess, Simpson Thacher & Bartlett LLP, 2016). In fact, the vast majority of directors may feel more comfortable and eager to

participate in an evaluation conducted by an internal facilitator, whether the corporate secretary, general counsel, fellow board members or the company's external counsel. However, it is not recommendable to use a company employee as a third party or 'interventionist' because of the high conflict probability. Rather, the board can select a member of the governance committee or an outside specialist to carry out the evaluation process. The first option is the most inexpensive and board members have the advantage that they are usually more familiarized with the topics in question compared to any external party. In addition, they can better preserve confidential information from disseminating to outsiders. However, there could be difficulties if the board member who performs as the interventionist is also involved in a particular problem that needs to be solved (Stybel and Peabody, 2005).

External evaluations favored by investors and literature. On the other hand, investors and the general media see independent governance consultants more favorably as they are perceived to have greater objectivity. They allow directors to be more candid in their feedback about board operations, and particularly in their self-evaluations and peer assessments. In this situation, directors feel more confident and empowered about expressing concerns that may not otherwise surface.

External advisors in general can be more straightforward in their analysis of the board than internal personnel when presenting the evaluation results. Additionally, governance consultants offer valuable experience since they have worked directly with other boards and addressed their issues.

The use of third parties has been broadly supported by literature. External experts monitor evaluation development and feedback procedures, preserving anonymity and the integrity of the process (Garratt, 1997; Kazanjian, 2000; Steinberg, 2000; Ingley and Van der Walt, 2002). An external facilitator could be an outside counsel or a governance advisory firm. The company should ensure to select one that they trust and that shows experience and expertise in board evaluations and corporate governance practices. Additionally, the external firm must not apply a generic approach, but gather all the necessary information to tailor the evaluation process to the specific needs of the board in question.

However, hiring a third party consultant can be pricey. Moreover, some directors may feel uncomfortable with consultants who attend their board meetings to oversee their performance and may thus be reluctant to provide relevant feedback.

Companies that are generally doing well tend to perform their evaluations internally, whereas they opt for an external consultant when they have to address compelling issues that the board does not feel qualified to address on its own.

In sum, the level of objectivity in the board evaluation exercise will depend in part, on who is in charge of conducting it. Literature has identified individual director self-assessment and internal boardroom evaluations as more "subjective" since they reflect directors' internal view on their own performance and therefore they lack contrasting contributions from peers or outside parties. Whereas evaluating the whole board or using an external facilitator contribute to a broader, more comprehensive approach and a more objective view. Given the nature of board reviews, external consultants must have the specialized skills required.

Limits of quantitative and qualitative evaluation techniques. Beck and Watson (2011) defend the use of both quantitative and qualitative evaluation techniques to assess board performance in relation to its role in strategy, planning, risk management, compliance, decision-making and governance. They also provide a snapshot about board competencies, structure and behaviors thus allowing the identification of improvement areas.

However, these approaches do not take into account the company's lifecycle and what are the pertinent corporate governance expectations for its level of maturity.

Additionally, as they just provide a snapshot of the board´s current situation, they cannot determine the following direction the board should take in order to address areas of improvement. Lastly, benchmarking the performance of a board in an objective fashion can be challenging, especially when the goal is to objectively measure the effectiveness of a board with traditional tools in comparison with other boards.

A number of shortcomings and problems arise from standard measures of board effectiveness. The subjective answers that are collected with traditional surveys plus the artificial setting in which they are taken often lead directors to give somewhat biased

answers. Qualitative comparisons with other companies and their boards afford a certain insight, and enable the evaluators to draw more powerful, focused conclusions based on potential differences and comparative results. Nevertheless, this method does not provide a holistic, all-encompassing and sufficiently structured way of assessment.

The board maturity model. Beck and Watson (2011) propose a model that concerns the degree of maturity of a board and how it compares to other boards at a similar stage of maturity in terms of performance and steps for improvements.

Based on a comprehensive assessment of over 350 boards and practical experience gained by the authors at “Effective Governance”, their practical approach maps out a strategic direction for the board. This allows for substantial improvements, based on the comparative evaluation approach, in terms of maturity of own board and other similar ones.

Maturity models can greatly enhance evaluation insights. This approach has a clear structure and two dimensions that describe the stages an organization moves through in terms of its maturity.

Dimension one tracks the development over time of the board moving through different stages of practices that govern its functioning. This first dimension comprises the cumulative stages of baseline level at the beginning and the final level, when best practices have been established and are consistently followed by the majority of board members.

Dimension two in the maturity model concerns the process of advancing to the next stage and the critical success factors for an organization to address key issues that potentially stand in the way of moving ahead seamlessly.

In line with this framework, there is a high-performance model of boards of directors that deals with the stages of the entire lifecycle where an organization is in at a given moment, and defines the steps to become a mature company in terms of corporate governance evaluation practices.

The following key topics are essential elements of the board environment perspective, as cited by Beck and Watson (201, p. 589):

- Strategy.
- Selection, monitoring and evaluation of the chief executive (CEO).
- Monitoring.
- Risk management.
- Compliance.
- Policy framework.
- Networking.
- Stakeholder communications.
- Decision-making.
- Effective governance.
- Board competencies.
- Board behaviors.
- Board structure.

By matching the performance of the board of directors with the typical behaviors described in the maturity model, the process of identifying the individual stage the board of directors currently is at becomes easily achievable.

Further advantages of the model include the reduction of the subjectivity bias since the specifically identified behaviors define the key areas and stages of maturity in a comparative fashion. Additionally, it is easily managed, allowing board members with tight agendas to quickly evaluate their board's performance. It also guides the board in the process to advance to the next stage of maturity, mapping out the specific actions the board needs to undertake. Boards can review the road map in every meeting and check their progress. Consequently, continuous improvement and the willingness to advance to the next stage of maturity are thus rooted in the board´s culture.

Finally, the board maturity model solves the problem of benchmarking boards in different stages of maturity, providing an innovative and comprehensive approach to

board evaluation.

Impossibility to evaluate objectively without clearly set objectives.

It is crucial for companies to consider the underlying objective of implementing an evaluation process (Conger et al. 1998; Conger 2002; Huse and Gabrielsson 2012; Cohn, Kess, Simpson and Thacher & Bartlett LLP, 2016). There are crucial reasons to perform board evaluations −accountability and value creation are the top ones. Evaluations also contribute to align board task expectations and actual board task performance. They also contribute to transparency and help boards to develop reliable corporate relations with relevant internal and external players.

Board evaluations may have the purpose of simply complying with the company's governance guidelines and any applicable stock exchange listing requirements; or they may be meant to measure the overall satisfaction of the directors with the work performance of the board or to address specific issues or deficiencies in the board's functioning (Cohn, Kess, Simpson and Thacher & Bartlett LLP, 2016).

Define the goals. Boards should consider all possible causes or influences before setting the objective of the evaluation. Some common issues are: performance problems, board size, skill set and composition, the maturity level of the company in the business life cycle and significant strides in the competitive environment (Chioatto, 2015).

Failure to be on the same page and to reach an agreement regarding the desired outcome, objectives and the purpose of the evaluation at the beginning will be detrimental to the process of overall improvement. These conditions have to be clearly set and agreed upon before the process is started.

Generate commitment. Commitment by the board members −time and effort− to effectively contribute to the assessment can only be achieved by reaching a collective agreement among the group of participating directors in terms of what they want to achieve (Spencer & Stuart, 2012).

Moreover, without such an agreement and initial commitment, the feedback by the

directors will not be as pure, frank and outspoken as it needs for the interventionists to be able to identify and later tackle obstacles that stand in the way of an effectively functioning board. Finally, this process of a clear goal definition at the start helps to mitigate risks that relate to directly addressing directors that show poor performance.

Often times, external stimuli or critical events in the evolution of a board, such as leadership changes, new management or changes in the organizational structure can have an influence on the way the assessment is set up, its priorities, desired outcomes and objectives. Change management activities in the way a board is assessed can help mitigate risks and undesired side effects of such organizational changes.

Spencer Stuart (2012) mentions the example of bringing in a new CEO into an organization and the effect an assessment that is conducted during this change can have on what the board expects, how it is held accountable and in what ways. Early mediation between new CEOs and board members not only helps to get a clearer picture of the roles each board member and the management team should optimally take, but also sheds light on the questions around structure, modus operandi and composition of the board and the effectiveness of these aspects from an organizational perspective.

Finally, and this is especially true in times of organizational change or external influential factors, corporate governance practices, structures of boards and the cultural dimensions governing board room practices differ widely depending on the type of company and the country it operates in. Board assessments, in turn, are directly or indirectly affected by those cultural, operational and organizational differences in terms of scope and style. It is important therefore to always consider potential differences in order to reach the maximum effectiveness of board evaluations, to choose what is best suited for the respective company's objectives. The aim is to provide a positive, swift and enlightening experience for all who are actively or passively involved.

A distinction between external and internal purposes is brought forward by Minichilli et al. (2007), who define the external purpose as one that is supposed to meet requirements relating to external norms and guidelines, including Codes, good governance rules or regulations. On the contrary, an internal purpose is one that aims at bringing about tangible changes to the performance of the board and board behaviors, as well as processes and practices that influence the boards work.

Establish the process. According to Minichilli et al. (2007), there are some elements that help to define the evaluation approach. If the evaluation has no purpose to accomplish or expectation to fulfill, it is impossible to compare current with expected performance. Understanding the purpose of the evaluation helps to: identify relevant expectations; define the process that will contribute to achieve this purpose; determine who will be in charge of the process, the contents, the methods and how to report the results: "*who does what, for whom, and how*" (Minichilli et al. 2007; Huse & Gabrielsson, 2012).

Conger, Finegold and Lawler III (1998) state that boards first need to set objectives for themselves in relation to their roles and responsibilities in order to gauge their own performance in meeting those expectations. Some of the board's main responsibilities are to develop and monitor the effective implementation of business strategy, to ensure high CEO and executive team performance and to guarantee that the company has adequate information, control, and audit systems to determine whether it is meeting its business objectives. Boards are expected to ensure compliance with policy and regulatory guidelines set by law and by the company's own value statements. Finally, boards are in charge of risk management.

At most companies, the nominating or governance committee creates an initial set of objectives at the beginning of the fiscal year. Later, the board, together with the company's CEO, analyzes and discusses them to determine the final set of objectives and to rank them in order of priority. In a third step, the board establishes the evaluation criteria to assess its own performance regarding the achievement of the company's goals. However, not every responsibility can be measured every year. The board must choose to focus in on four to seven areas they consider the most essential to the company's success.

Match between objectives and process. Ulysses Chioatto (2015) insists in the fact that a board evaluation will not achieve its purpose unless there is a fit between the objectives for the review and the method employed for the board evaluation. First there must be an understanding of the underlying motivation to carry out an evaluation process, then, key factors must be considered such as agents, participants, and methodology. He lists the factors to consider as the following:

- *Setting objectives*: it can be delegated to a small group of the board (the governance

committee or the nomination committee) or to an individual (chair or lead independent director). Consulting with an external adviser to overcome '*board blind spots*'/biases is ideal.

- *Who will be evaluated*: Cost or time constrains often preclude a wide ranging review of the performance of:
  - The board as a whole (including committees).
  - Individual directors (including the roles of chair and/or lead independent director).
  - The CEO and company secretary.
- *Group vs individual*: There is the potential to create serious conflict within the board if individual performance evaluation is introduced when some directors are opposed to the process. Consensus must be reached before introducing such a process.
- *What will be evaluated*: the majority of governance concerns are the result of the interplay between individual skills, experience and motivations; the relationships between board and management; and the effectiveness of supporting governance policies, procedures and processes. (Chioatto, 2015. P. 418).

Board competences and skills matrix. According to Chioatto (2015), every board of directors in Australia nowadays, whether from a non-profit organization or a listed firm in the Australian Security Exchange (ASX), must have available a framework to evaluate themselves, otherwise they cannot function as a legitimate government body in the organization.

Generally, boards should consider their specific objectives in light of the corporate governance framework. In Australia, the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* provide a framework which the board can utilize to develop topics and/or questions for their board evaluation process.

For instance, as stated in Recommendation 2.2 of Principles and Recommendations, "*A listed entity should have and disclose a board skills matrix setting out the mix of skills*

and diversity that the board currently has or is looking to achieve in its membership". Accordingly, an optimal board evaluation framework should have as a particular evaluation objective to assess the skills and diversity of the board. Boards must review their skill set to adapt to the demands of a changing environment, for instance, changes in the strategy or in the competitive environment. Furthermore, the assessment of skills gaps will depend on boards' characteristics such as size and composition, and functions such as risk management, strategy formulation and monitoring of management.

Another issue to consider in board evaluations is the one stated by "*Principle 2: Structure the board to add value"*, which helps to assess if the board has the proper structure, skills and experience to function efficiently. It helps to identify if the board has the right size and composition to comply with its duties and responsibilities. Some companies, for example, maintain a matrix of desired skills for board recruitment and succession planning purposes. Then they use it as a base for reflecting the skills directors bring to the board.

Disclosure of the evaluation process is another important requirement in "*Recommendation 1.6 (a) 'disclose a process for periodically evaluating the performance of the board...' and (b) 'whether a performance evaluation was undertaken"*. (ASX Corporate Governance Council's Corporate Governance Principles and Recommendations, 2014, p 13)

Similarly, Beck and Fibich (2013) recommend companies to do a competence analysis to know if their boards have the needed skills. The analysis includes an inventory of the competencies a board has and the skills gaps. This helps organizations and directors to reduce the risk of taking poor decisions due to deficient knowledge of the company's industry, strategy, compliance, risk management or the financial aspects vital to the viability of any organization.

Directors having specific competences in accounting, legal or marketing qualifications to perform within the expected standards does not guarantee an effective performance. In fact, even highly competent directors can fail due to unexpected personal or environmental factors. Therefore, an analysis of directors' competences should include four areas (Nicholson, Tunny and Beck, 2012, p. 204; Beck and Fibich, 2013, p. 594):

- *Behavioral:* The attributes and competences enabling individual board members to

use their knowledge and skills to function well as team members and to interact with key stakeholders. For example, team player/collaborative, ability and willingness to challenge and probe, common sense and sound judgment, integrity and high ethical standards, mentoring abilities, interpersonal relations skills, listening skills, verbal communication skills, understanding of effective decision-making processes, willingness and ability to devote time and energy to the role.

- *Governance*: The essential governance knowledge and understanding all directors should possess or develop if they are to be effective board members. It includes some specific technical competences as applied at board level. For example, director of a medium organization (10-99 employees), director of a large organization (100 or more employees), financial literacy, strategic thinking planning from a governance perspective, CEO/executive performance management, governance related risk management experience, compliance focus, profile/reputation.
- *Technical*: Technical/professional skills and specialist knowledge to assist in ongoing aspects of the board's role. For example, accounting, finance, law, marketing, information technology, experience in developing and implementing risk management systems, human resource management, CEO/ senior management experience, strategy development and implementation.
- *Industry*: Experience in and knowledge of the industry in which the organization operates. This also includes knowledge of broad public policy direction and understanding of legislation and legislative processes.

The board nomination committee should design a list of the competencies they want in a director, based on the four areas described above. A skills matrix can be used to evaluate boards' required capabilities against the mix of skills the board currently has. Board competences can be measured in different levels of performance a director has, for example, from none to expert.

According to the authors, companies can improve their performance not only if their directors possess these skills but if they also make good use of them. Performance results can be measured through board evaluations. In addition, they recommend peer evaluation to provide effective feedback for underperforming directors.

Fit for purpose board. Beck and Fibich (2013) propose the concept of a board being "fit for purpose" when the board can adequately handle and fulfill all requirements and responsibilities essential to optimally serve the company. A board's state of being fit for purpose is reached when collaboration and realization of work-related tasks is coined by harmonious effectiveness and efficiency. Beck and Fibich highlight this idea by mentioning examples of board failures linked to the global financial crisis. More specifically, appropriate behaviors often times were ignored or unseen; boards were neither willing nor able to go into arguments and serious discussions with management. Such incapacity to challenge the status quo upheld by management stands in stark contrast to an effectively functioning board, which typically operates like an effective team: cohesive, collectively committed to shared goals and values, as well as consciously embracing conflict and constructive criticism.

It is important to note that these characteristics are by no means meant to be a substitute for competence of the individual board members. They can, however, serve as an activating agent for best practices, foster optimal use of the board members and guide them to collectively perform their tasks, roles, and responsibilities in the interest of the organization.

The right competences. Many regulatory and legal frameworks, for instance, consider a board member a competent one if his or her competencies reach beyond the scope of an independent and financially literate person. The base of the competency question, however, hints at board performance and thus entails a standard type of board member, who is knowledgeable in general, knows specific content about the organization and the industry it operates in, as well as personal skills and leadership abilities (Beck and Fibich, 2013). Finally, socio-emotional skills, emotional intelligence and empathy, the soft-skills in the spectrum, must not be forgotten when considering the optimal set of competencies for a member of the board.

The high complexity of organizational contexts existing in today's business world makes a personalized and individualized approach to competencies of board members difficult. It is nearly impossible to cater to the requirements of a certain organization with a one-size-fits-all approach, given the vast amount of variables and multiple contextually contingent dynamics that have to be factored in.

The actual situation that is encountered most frequently entails a wide variety of competencies that are required for individual companies and boards. Fit-for-purpose for one board does not mean fit-for-purpose for another board and the same goes for two different companies as almost no two companies and no two boards are the same. By definition, then, a fully satisfactory fulfillment of all individual competencies desirable for board members that are supposed to serve on a given board is hard, if not impossible, to achieve under normal circumstances.

An important point to make concerns the individual contribution of directors. Effective contribution of each individual board member is crucial, but exactly the same type of performance and engagement level is not needed from each director, in order to have effective corporate governance. The key is to reach a situation in which each individual director is providing a contribution in line with their individual competence set and capability range, so that the appropriate level of engagement on both ends −board as a whole and individual board member− is reached.

It is important for boards to notice that board member competencies cannot be instigated at once but require time and continuous effort to build up over the long term. Individual directors will grow and develop themselves while serving on the board, rather than joining with a perfectly refined set of competencies to unanimously meet the organizational requirements. The key is to foster an environment where board members can develop and are stimulated to grow as a group. Such a learning environment should also have room for adjustments and redirecting changes as a board may have different requirements −in terms of the skills, abilities and knowledge base as well as competency sets− over time, in line with changes in corporate strategy, goals and market conditions.

The successful board evaluation process. The process cannot be seen as an array of individually executed, independent steps, but instead features a set of elements that are intrinsically intertwined and evolve in a constant flux of integration, accountable governance and improvement. For instance, skills of individual board members might have to be assessed to ensure that the board is adequately equipped to face the challenges and projects that have to be tackled organically and systematically to

substantially improve the organization's performance in the short, medium and long term.

Furthermore, the successful evaluation of board performance is crucially dependent on objectives that are being set on an annual basis, the collection and dissemination of information regarding the degree of fulfillment of the set objectives, as well as the continuous implementation of improving mechanisms based on observation and critical reflection during the evaluation process.

A successful board evaluation is also characterized by a positive attitude towards reviewers and evaluators who are recommending improvements. Only with such a positive stance can board evaluations be turned into positive progress and desired outcomes in the best interest of the organization. Another key to success, which goes hand in hand with implementation processes, is the integration of the remaining corporate governance elements and procedures, including adequately and objectively selecting directors, providing guidance to and educating board members, as well as implementing mentoring schemes and self-reflection sessions.

Even though these steps may appear difficult and challenging in terms of feasibility, following the step-by-step processes most likely will lead to a beneficial experience for all participants offering great transformational power. Breaking down required steps to reach milestones into smaller parts is crucial to success and to the positive management of emotions and motivation. Even for board members that turn out to be less effective or even counter-productive after the evaluation process, its inclusive nature and transformative potential allows for individual adjustments. It can induce self-reflective behavioral changes towards positive influence and fruitful contribution to the functioning of the board. Positive change and professional improvements both on the individual as well as the collective levels can be achieved and board functioning will thus be significantly enhanced.

In sum, literature recommends board evaluations to be performed against set standards and best practices or in comparison to other boards. However, what is useful for a board does not have to be so for others. For instance, not all directors need to be exceptional in all the possible areas of development/competence (behavioral, technical, governance, industry areas as stated by Nicholson, Tunny and Beck, 2012 and Beck and

Fibich, 2013) but the organization must know what specific features are required to achieve their corporate goals.

Only by having a deep understanding of their own board members, their competences, skill gaps, strengths and weaknesses, group dynamics and culture, etc. will the organization know which corporate purposes to set in their governance body and be able to determine the best improvement strategies.

The shortcomings of current board evaluations

As we have seen, the most complete of board evaluations using the full range of techniques would cover the following areas:

- Board attributes.
- Board composition.
- Board culture.
- Board leadership.
- Board structure.
- Board competences.
- Board functioning: number of meetings, time devoted to board work, information received…
- Oversight and compliance function
- Risk management function
- Strategic function
- Board Dynamics
- Succession plans
- Directors' engagement
- Director orientation and induction programs

If we examine these areas closely, we can conclude that most of them are intended to analyze the board itself, its more or less effective features and ways of functioning. There is also a set of well-established and more or less generally accepted standards regarding composition, structure, competences, etc.

For instance, regarding structure and composition, it is considered better for the board chair to be independent from the company's CEO. The number of independent directors should be higher than lower. Diversity of gender, race and perspectives is perceived as desirable and an enhancer of board effectiveness. A collaborative culture which also welcomes dissent will consistently yield better results. Competences and experience sought in directors vary according to industry, company and country, but there are some traits that are particularly desired, such as perhaps international experience and knowledge of other markets. It is also considered preferable to have specific succession plans, to implement the right induction programs for new directors, training sessions for the whole board and its individual members, and so on so forth.

All of these are taken into account in evaluations and may be even measured against standards used in best practice, and/or proposed by regulators, codes of good governance and the academic literature as well. Boards scoring high in the desired traits, behaviors and fulfillment of their functions are certainly more effective than those found lacking in any of the areas considered.

If indeed progress is measured −whether in comparison with other boards or comparing results to the ones obtained by the same board the previous year− and improvement action plans are designed, followed and monitored, the board will be improving its effectiveness in the way it functions. However, these are times for boards to go beyond doing a reasonable job about the traditional functions such as oversight and compliance or risk management.

As currently conceived and conducted, board evaluations miss a very important point. They do not consider, in a specific and measurable way, how and what the board is contributing to the overall success of the company. What does the board add to the corporation's performance, to the achievement of corporate goals, be they what may. This work contends that evaluations adding this perspective −through the use of concrete and measurable parameters− would be substantially more useful, meaningful and also fully functional. Underperforming directors would be easier to identify and replace. Boards as a whole and its individual members would feel less complacent and more compelled to contribute to the best of their ability to the specific annual goals set for the corporation they serve.

As far as evaluation processes are concerned, the use of such methods as self-evaluation or peer evaluation seems perhaps to be effective for improving the traditional traits and functioning ways of boards. However, they almost certainly lack objectivity and independent perspective, since board members end up being judge, jury and executioner.

In the next chapter of this dissertation the new method of board evaluation will be presented. Hopefully, it may complement and even improve current board evaluation practices, particularly in the case of small and medium sized companies.

VI. 21st Century Method to Evaluate Board Performance

Strategic role of boards

From Chapter I in this dissertation, it is clear that the role of boards should be enhanced, reinforcing its control and independence, but also, and more importantly, increasing their strategic impact on the companies they serve.

The survey performed by Advisory Board Architects (ABA) - the author's board advisory firm - for the purpose of this work, reinforces this notion. A high percentage of the survey's respondents, 71%, indicated that the primary role of their board is strategic, with "governance" and "oversight" following with 48% and 46%, respectively. Furthermore, when asked about the three top ways the board added value to their organization, 72% ranked "strategic direction or vision" first, with "executive team accountability" following with 31%.

The enhanced role and increasing strategic importance of boards is evident not only in large corporations, but also in SMEs, as seen in Chapter II. Small and medium sized companies have perhaps been pioneers in this sense, as the control role of the board in this type of corporation has been traditionally less important due to the more closely held ownership structures they generally exhibit.

The review of various board theories and their view of evaluation in Chapter III reveals that boards may have various roles depending on which theory you consider. *Agency* theory posits a conflict of interest between owners (the principals) and managers (the agents) and therefore prioritizes control as the role of the board. The *Stewardship* theory proposes a more collaborative relationship between these two actors, proposing the board act as "stewards" of the corporation helping the management to understand the markets, shape strategy and make decisions. The *Resource Dependency* theory sees the board as a "boundary spanner", a group that helps the management to see and go beyond the borders of its knowledge, skills, experience and network thus furthering the aims of the corporation. *Stakeholder* theory proposes that the interests of stakeholders beyond those of just shareholders should be considered in determining the role of the board. This requires the company to identify its stakeholders and understand their various interests. "*Enlightened Stakeholder theory*" suggests long term value

maximization as the way to make tradeoffs between stakeholder interests when a conflict arises. Kaplan & Nagel's proposed Board Scorecard reflects the interests of stakeholders and how the board should perform to meet them. Finally, some authors, such as Huse (2005), Minichilli (2007), Huse and Gabrielsson (2012) and Rasmussen (2015), have tried to enhance practical application of these different theoretical perspectives by combining two or more of the theories.

It seems clear from the above that the board can have a number of different roles – probably more varied than the theories that try to explain them – and that boards work in any number of different companies, in different markets and different places, under different regulatory frameworks.

It is also clear that, as boards become more active and influential, helping to generate sustainable competitive advantage for companies, the importance of measuring their performance increases, as evidenced by calls from investors, stakeholders and the academic literature for systematic and regular board evaluation practices.

Boards may be assets or liabilities

Boards are either assets or liabilities for the companies they serve, and measuring their performance through board evaluation is widely recognized as an essential part of ensuring they are truly an asset with a real return for the company. Yet the evidence shows that not enough companies are making use of this powerful tool to improve the returns they obtain from their boards. Adding to the evidence already presented from listed companies around the world, ABA's survey -which covered mostly non-listed companies globally (90% of the sample were non-listed companies)- showed that 19% of firms conducted board evaluations, 71% annually and 20% every two years.

We have seen that performance evaluation systems (PESs) are used regularly by companies to monitor and improve individual and corporate performance and that empirical evidence supports the conclusion that PESs help improve performance. However, we have also seen that individuals higher up in organizations, with more ambiguous and unstructured tasks, are the least examined. Performance appraisals for these individuals are less frequent and more arbitrary.

A similar difficulty has been identified with board evaluations, where key elements such as targets, improvement measures and outputs are routinely left out of most evaluation processes. As can be concluded from the literature, these targets should be set in advance. Except in some meritorious real cases we reviewed (such as Banco Santander), specific goals related to the business do not seem to make it on to the list of the board's tasks to handle, making it impossible to evaluate against such objectives.

Furthermore, to add to the difficulty, because boards are collegiate bodies at the apex of corporations, board evaluations cannot be vertical, as is the case with management appraisals, but rather horizontal (or peer) evaluations. Because objectives are rarely defined, the discomfort of evaluating peers is aggravated by doing so based on subjective criteria in most cases. Although all the theories on boards, in one way or another, explain the goals of boards as derived from the interests of stakeholders, it seems that these interests are rarely used to set objectives for the board except in the most general ways (compliance).

This leaves boards to be checked for performance against lists of items with a fundamentally standard, compliance driven focus, frequently provided by regulators. The board's performance should be checked against a roadmap set not as (or not only as) a function of regulations and recommendations, but rather as a function of the company which the board is serving and what the company is striving to achieve in the interest of its stakeholders. Only in this way can board evaluations serve as a real tool to align the objectives of stakeholders, board and management, generate accountability and actual task performance, and ensure value creation, since not all organizations will define each of these elements in the same way or attach to them the same degrees of importance.

An additional aspect of board evaluation is the commitment to the process of those involved. It is clear from the evidence that a commitment of time and effort by the board members is essential for a successful process and that such a commitment will be most likely and productive if the board has a culture of trust and open communication and if board members are open to receiving feedback. This quality is essential for an effective board member. Evidently, an additional key requisite for generating commitment is making the evaluation process as simple and swift as possible, providing clear outcomes and action plans both collectively and individually.

Finally, due to the subjectivity involved in peer evaluation of insufficiently defined objectives, investors, the literature and even some regulators favor the use of third parties to provide greater objectivity to the process. Third parties will tend to be more sanguine in their evaluations and straightforward in their feedback to all actors involved. If expert, these third parties will also be better able to benchmark with external comparators. The objectivity of third parties, however, will only increase –and with it the value of the evaluation exercise– if they are provided with objective, company specific criteria to evaluate.

Successful board evaluations

In view of the above evidence, detailed throughout this dissertation, it stands to reason that the following qualities are important for a successful evaluation process:

Systematic. The evaluation should follow a pre-established process to ensure consistent outcomes. This process should define, among other things, *who* and *what* shall be evaluated, *how* and *how often*. The process should be as simple as possible while considering key aspects to evaluate. It should combine quantitative analysis with qualitative elements in order to cover all aspects of board performance. All participants should understand and buy into the process.

Objective. The objectives the board must meet in order to help the company progress must be defined. They have to be set in advance to become the parameters against which the board can be evaluated. The outcomes of these objectives should be measurable and, ideally, quantifiable. The potential elements to consider are described in the third section of Chapter V. It is important to clarify that these objectives are not for the evaluation process but rather for the board. The distinction is important, since, as we have seen, there is usually heavy emphasis placed on the objectives of the process itself. Furthermore, the evaluation process should consider board processes as well as specific outcomes.

Specific. Both the process and the objectives established should be specific to the needs and strategic goals of the company and aligned with the interests of key stakeholders. The evaluation should be able to identify if the board and each of its members is “fit for purpose” for the specific case of the company they serve.

In the following section a novel and comprehensive process is described for determining board objectives, defining the characteristics, structure and processes of the board and for evaluating board performance against those objectives.

It is novel in that, unlike methods described heretofore, it measures company specific variables in many aspects, including particular objectives the board will strive to meet, as well as process variables that are more generally applicable and which, therefore, can be benchmarked across different company boards.

And finally, it is comprehensive because, by beginning with a detailed analysis of specific company needs and basing goals and board composition, structure and process features on that analysis, it covers all the elements a board will need to successfully cover in order to be high-performing.

The proposed process

Every company has its own set of needs, goals and strategic circumstances and therefore each company will have a different set of requirements from its board.

An effective board evaluation system will therefore have to consider these needs, goals and circumstances. Furthermore, to be truly effective, the evaluation system will have to be as objective as possible. An objective evaluation system will be of great value in reducing potential negative repercussions from board evaluation, as it greatly reduces the weight of individual subjective judgments regarding performance that characterize the prevalent self-evaluation methods.

As evidenced in previous chapters, it is infrequent at best for companies to consider evaluating their board based on objective and measurable criteria that are specific to their current and near future needs. Doing so, however, maximizes the possibility of the board having a high level of strategic impact on the company and helping it to achieve its objectives. Furthermore, doing so in advance and in a dialogue with all involved, ensures alignment between the board and stakeholders and the board and management. As mentioned previously, not doing so makes objective evaluation impossible.

The process described is a “virtuous circle” in which needs are defined, goals are set, actions are taken, performance is measured against objectives, and objectives are annually reevaluated to ensure alignment with evolving company needs.

Company’s needs. The starting point for the process is the definition of the needs the company desires its board to fulfil, in alignment with key stakeholders’ interest. This will be the focal point of the goal setting exercise. These needs and the objectives derived from them can be short, medium or long-term in nature. Overall goals can be broken into elements which are measurable in some way and whose progress can be tracked. These objectives should be reflected in detail in a document which can be called a Board Charter.

The Board Charter ensures that all individuals involved are on the same page regarding what the company needs from its board and how the board is expected to satisfy those needs. The Board Charter will also consider board composition, structure and processes, in light of the needs and objectives set, to ensure that the board is “fit for purpose”, that it is indeed prepared to achieve the proposed objectives. Elements to be considered are the characteristics – knowhow, experiences and personal traits – members must bring to the table as a team and the processes the board will follow in order to meet its objectives in an effective way, in other words, that board design is aligned with its purpose.

Regarding the time frame, a Board Charter should be defined and agreed upon twelve months in advance of the first evaluation.

A board without a Mandate will yield results, but it will be very difficult to ascertain if these were the results that the company wanted or needed, whether they are good or bad, and if they had a positive or negative impact on the company’s performance, since “good” and “bad” are subject to interpretation in light of the company’s strategic purpose at that specific time.

The next two elements of the process -Control and Compliance, and Performance and Objective Measurement will be defined and considered relative to what the Board Charter defines.

Control and Compliance Process. Once the company's needs have been established and the board's objectives to satisfy those needs have been defined and formalized in the Charter, it will be necessary to determine the framework within which the board will conduct its activities and how the various players (stakeholders, board and management) will interact.

A system will have to be defined and implemented covering the necessary processes and procedures to ensure it is possible to evaluate board performance (both collectively and individually) as well as board processes relative to the defined objectives.

The characteristics that are needed on the board, as established in the Charter, will be essential in examining the profile of current board members and in considering whether changes need to be made to board composition. Counter to most current practices where board members are found through existing board member networks, the addition of new board members should happen through a rigorous selection process based on a matrix that defines the knowhow, experiences and personal traits desired in new members. Composition will also be considered collectively, to understand if the board members together form a cohesive and coherent team that provides the necessary skills and knowhow.

The Board Charter will explain and board members will know and understand that – subject to the necessary safeguards to their independence – their tenure may be finished if their capacity to contribute has diminished, either because they have contributed what they had to contribute or because the company's needs have evolved. This understanding helps to minimize the discomfort associated with asking a board member to step down. This is also a measure that shows respect to board members' most precious and irreplaceable asset: their time.

To ensure every board meeting is productive and deals with topics that are relevant at all times, it is essential to generate and agenda and board documents that focus the time and effort of the board. The topics will be defined by the goals set in the Board Charter and by the needs the management or the board itself may have at any given moment.

The agenda will detail the items to be dealt with in the meeting, assign specific times to discussion and debate of each one. Although some evidence shown above pointed to board members wishing to dedicate more time to board meetings, it is important to point out that quantity and quality are not the same. A well thought out agenda is essential

for maximizing the productivity of each meeting. Furthermore, all relevant –and *no irrelevant* information– will be sent out at least 7 days ahead of time, to allow board members enough time to prepare and to minimize presentation time during meetings. It is all too frequent for management team members to prepare "board presentations". In most instances, these are either redundant -if the relevant information was sent out in advance- or a suboptimal use of board time, if not. It is common sense that board members who are faced with information for the first time during a board meeting will not have time to adequately reflect upon it.

Supporting documents will be prepared to a) provide updates on the evolution of the company and key strategic initiatives and b) provide context for a discussion to take place at the board meeting. The update documents are intended to minimize the time devoted to "reporting" on the board and to maximize the time spent on productive debate and discussion of future initiatives. The documents used to provide context should detail the relevance and objective of the discussion and provide all pertinent –and *no irrelevant*– information, as well as specific requests from board members, as they prepare. If board members understand the objectives of the discussion they will be able to better prepare for and contribute to the debate.

The chairman should moderate meetings to ensure the effective participation of all board members and that all topics have been adequately debated, and the desired objectives for each topic reached.

Notes of the meeting must be taken to describe in detail what has been agreed, emphasizing too tasks that have been assigned, to whom and the date on which they must be completed. Individual board members' contributions have to be noted too. This information is then compiled in a tracking document, which becomes a "live" document recording completed actions and incorporating new contributions and agreements, over the life of the board. This tracking mechanism is of key importance at the time of evaluation.

Measuring performance. This section covers the process of measuring performance against set objectives on a collective and individual basis.

As mentioned above, a standard set of performance criteria for all boards is of relatively little use beyond measuring compliance and benchmarking with best practices. Some simple process elements that are sometimes measured, such as attendance, are so evident as to be almost ridiculous. Compliance and some of the more basic process elements may be important –as attendance obviously is– but is certainly not enough to assess the strategic impact of the board on the company. Additional elements need to be considered as well, to be able to determine the contributions of individual board members and the impact these may have on reaching the board's and the company's goals.

It is important to focus, therefore, on elements the provide real insight into board performance, such as:

- Key performance indicators (KPIs) that reflect the impact of contributions made by the board members vis-a-vis the objectives defined in the Charter.
- Surveys that evaluate, more generally, process related objectives and other qualitative variables.

Both KPIs and surveys should be developed considering the objectives and processes set forth in the Charter. This is the only means of gaining insight into the impact of board contributions towards those goals and into the effectiveness of the processes.

Two main evaluation tools are proposed here: a) a post-meeting survey and b) an annual evaluation.

The post-meeting survey. After each meeting, a survey will be administered to all involved, to gather their input regarding primarily the following aspects:

- Meeting effectiveness.
- Perceived impact on board and company objectives.
- Perceived quality of the discussion.
- Perceived preparation of board members.
- The relevance and quality of information provided before the meeting.
- The value the meeting has had for the board members.

This survey takes a relatively short time to complete and can be administered online. It is decisive to conduct this survey after each meeting. It allows for immediate corrections to less than effective board processes and makes each meeting more impactful than the previous one. Furthermore, it is a novelty to consider the value of each meeting for board members, and yet, as pointed out by proponents of Stewardship theory, many board members are intrinsically motivated by performing challenging work and delivering results, and most everybody is unhappy if they believe they are wasting their time. This type of motivation is frequently a greater incentive than monetary compensation for board work and drives board members to become ever more engaged with the company.

The annual evaluation. Once a year, a broad evaluation encompassing all stakeholders considered when preparing the Board Charter is conducted. This assessment uses three elements:

- Measurement of the KPIs used to track performance relative to the objectives set out in the Charter.
- Trends revealed in post-meeting surveys over the course of the year;
- A set of questions to be put to all board participants, including an open-ended question relative to possible improvements and changes in objectives, which may need to be reflected in the Board Charter.

Evaluating the KPIs will provide an approximate quantification of the value added by the board and reveal its contribution to the objectives set out in the Charter. It also ensures that the company knows if and when some of those objectives have been fully achieved. The review of post-meeting survey trends will allow the evaluation of board processes over time and the results of the annual surveys will bring further insight into those processes, in order to identify the potential need for changes in objectives.

The combination of these three inputs will generate detailed knowledge of the value created by the board, its level of achievement regarding its objectives and the relative effectiveness of its processes. This in turn will be the material necessary for a board discussion to cover the following topics:

- What objectives have been achieved and are there new or follow-on objectives to replace them?
- What objectives have not been achieved? Were they relevant? If so, what needs to be corrected or additionally done to achieve them? If not, are there new objectives that need to be added in their stead?
- What processes have worked particularly well and what have we learned from that? What processes have not worked well and what can be done to improve them?

The outcome of this discussion should be amendments to the Board Charter in order to reflect the following changes:

- Elimination of objectives achieved.
- Amendment or elimination of objectives not achieved.
- Inclusion of new objectives to be achieved as a result of company evolution or changing stakeholder interests.
- Modifications in composition, structure or processes that are needed as a result of changes in the objectives.
- Changes to composition, structure and processes that are needed as corrective measures. Obviously, one of the possible outcomes of this reflection is that proposed changes in composition may result in the addition or subtraction of board members, based on the qualities they brought to the table relative to the objectives in the Charter.

How to evaluate quantitative aspects. A particularly relevant aspect of this method is how to evaluate KPIs, or quantitative parameters of board effectiveness relative to objectives set out in the Charter. In this regard, it is important to point out that there are two aspects of this analysis a) the absolute and b) the relative. The absolute relates to the *total completion* of a certain objective, in other words, when a specific objective has been achieved or, indeed exceeded. The relative relates to the *partial completion* of a specific objective. Total completion causes an objective to be taken off the Charter and a certain value attributed to the board for its completion. Partial completion causes a reflection on the relevance and importance of the objective as well as the attribution of some or no value to the board for its partial completion.

Having said this, objectives fall into two broad categories, those that are relatively easy to quantify and those that are difficult to quantify. In either case, the attribution of some value to the board is an *indicative* measure meant to provide a range of value to the performance of the board and therefore an indication of the return the company obtains from its investment in the board as an *asset*.

Contributions that are relatively easy to quantify are those that lead to direct improvements in specific aspects of the business with relatively little effort or learning needed from the company, such as an introduction from a board member to a large client which generates a certain gross margin thereafter or to a new supplier that may allow for a cost reduction.

Less easy to quantify are contributions that allow the company to make improvements but require some effort or learning on the company's part. Examples of this would be contributions from board members leading to improvements in the capital structure (which could result in financial savings or access to new capital), or to the discovery of a new business vertical (which could result in profits but after a certain investment and learning curve).

Finally, the most difficult to quantify are those contributions that are potentially most impactful. Examples of this are contributions which lead the company to significantly alter its business model or those related to changes in the firm's top leadership. For the last two cases the range of the value that may be attributed to the board widens and, in the most difficult ones, perhaps the only way to calculate an estimated value is to consider how a specific contribution increases the probability of reaching specific or overall profit objectives.

Evidently, these are not perfect nor exact measures, nor are they intended to be. The potential impact of a highly effective board on a company relative to the reasonable ranges of cost (*investment*) it generates is such that the return on investment (value provided divided by total cost of the board) should be in terms of multiples, not percentages. That is, a board that is highly effective should provide a company with a value of more than X times – at least 5 times, in the author's experience – its investment. One providing a 30% - 70% ROI, while not a bad investment in conventional terms probably has significant room for improvement.

A proven method

In conclusion, this chapter has described a process for board evaluation that is novel and comprehensive. Guidelines are provided for:

- Establishing company specific objectives that consider stakeholder interests.
- Establishing more general process related measures intended to maximize board impact on company specific objectives.
- Measuring board contribution to company specific objectives in a reasonably quantifiable way.
- Evaluating performance on a per-meeting basis from the process standpoint.
- Evaluating performance on an annual basis from the standpoint of the company specific objectives, the process objectives and stakeholder interests.
- Using the process of evaluation to incorporate lessons learned and provide the basis for reviewing board objectives, composition, structure and processes. The overall goal is to maintain alignment of the board with stakeholders and management, despite changing stakeholder interests and evolving company objectives.

The method described above complies with the three key features of a successful evaluation process:

Systematic. The evaluation follows a pre-established process to ensure consistent outcomes. It defines *who* and *what* shall be evaluated, *how* and *how often*. Although the process cannot be described as "simple" it is straightforward. It combines quantitative analysis (for company specific objectives) with qualitative evaluation of more general, process related variables, and it provides elements to analyze and reflect on all aspects of board performance. All participants will be able to understand and buy into the process.

Objective: Guidelines are provided to set company specific objectives in advance and for evaluating them on a regular basis. The method also provides a means to measure and, within a range, quantify to which extent the proposed objectives have been achieved. It considers board process as well as specific outcomes.

Specific: both the process and the proposed objectives are tailored to the needs and strategic goals of the company and aligned with the interests of key stakeholders. The evaluation is able to identify if the board and each of its members is “fit for purpose” for the specific case of the company they serve.

This method has been successfully applied by the author in medium and small sized companies from a variety of industries and countries and at different stages of development. The following section presents three examples of real life cases where the new evaluation method has been implemented. The purpose is to illustrate the actual functioning of the method.

The following sections of this chapter present three real life examples and provide all relevant documents. These show in detail how the process of implementing a board and evaluating its contribution works.

Case Studies

To illustrate the methodology for the evaluation of board performance, three case studies are presented, based on three different types of companies. Each has its own specificities regarding the industry they operate in, the composition and role of their boards.

The companies include a health care industrial company (Mireia Care), a home appliances retailer (Zen Appliances) and a multi-sector, multi-geography private equity fund (Fund First Value). All three examples are real professional experiences of the author of this dissertation. However, the names and figures in the examples are fictional, in order to protect the confidentiality of the companies and to ensure that the information is used for no purpose other than this dissertation.

The author has worked and continues to work with a number of companies. In each case, including the three presented here, the same process is applied. The key steps followed are described below:

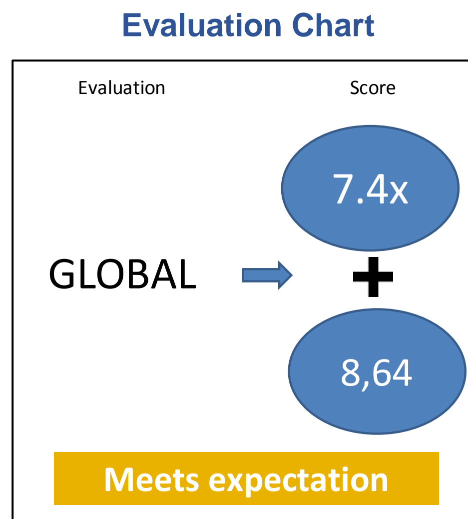
1. **Definition of a Board Charter**. The Charter includes the following aspects**:**
    a. Identification of the company's strategic objectives and how the board should contribute to achieve them.
        i. Fixing of KPIs to measure contribution of the board.
    b. Identification of skills, knowledge and background the Board members should contribute, according to the objectives defined.
    c. Recruitment of board members to cover the needs identified in the previous step. If a board was already in existence, consider making adjustments in the composition, immediately or over time.
    d. Identification of all process variables (number of meetings, duration of meetings, documentation (including preparation guidelines and timing) and Executive Follow-Up Document.

2. **Management, facilitation and follow-up of the board meetings** according to the guidelines defined in the Board Charter. This step is implemented through:
    a. Agreement and preparation of the agenda for each meeting, with clear objectives to be achieved in the meeting itself.
    b. Advising management on the preparation of the documentation. It also includes editing the documents prepared, from the point of view of the board member.
    c. Facilitating the meeting to reach the objectives set out in the agenda.
    d. Taking notes to develop the Executive Follow Up Document which is used to track contributions and ensure the follow through on agreed actions.

3. **Board´s performance evaluation and review of the Board Charter.** This step is implemented through:
    a. Measuring quantitative KPIs –annually.
    b. Measuring qualitative process variables –per meeting and annually.
    c. Providing feedback to board members individually.
    d. Facilitating a discussion within the board regarding the annual evaluation and the necessary changes to the Board Charter and board processes, if needed.

With the outcomes of the last step, the process stars again, being substantially identical, if changes in the composition have been agreed, or skipping steps 1.b and 1.c if not.

The final visual output of this step is a chart, like the one below, combining the quantitative (ROI derived from board impact, presented as a multiple of the "investment" in the board) and qualitative (survey results) scores. The scale goes from 1 to 10, with 10 being the higher score. The reader will observe that all the cases presented have significant profit multiples derived from board action and high qualitative scores. Using this method, the author has not yet come across one case, in which the board does not perform at a reasonably high rate of impact, with high results as well in the process variables survey.



Experience indicates that obtaining a return that is less than 5 times what the company invested in the board is low. Furthermore, to avoid a potential positive bias in the surveys and because these are intended to be *high performing* boards, in practice, any score below 7 is the subject of particular attention. A board that is managed in a disciplined way, obtains high scores.

Finally, the combination of the two aspects is considered. A board obtaining a high process score with a relatively low multiple may indicate that the board's efforts may not be focused on activities that generate a high return (or focused on too few activities), suggesting a need to review the objectives. A lower process score, with a high return may indicate that there is room to further improve the results by making positive adjustments in the process. A low process score combined with low return suggests that the process needs to be improved and objectives reviewed. The author's experience is that improving the process will generally improve the return multiple, but immediate action should nevertheless be taken on both fronts. Finally, a high process score with a

high (in excess of 10x) multiple indicates all is going smoothly and the board is ready to take on new, greater challenges.

The reader should note that the information provided is not the same for each example to avoid repetition of information that is not relevant to the evaluation process. The first case presents the description of skills and experiences (qualities) the board needs to contribute to illustrate the process followed, while the next two do not, as it is not relevant to the evaluation process.

The information presented is the following:

Mireia Care

1. Objectives as per Board Charter.
2. Description of skills required of board members according to the company's Board Charter.
3. Evaluation of Board Performance:
    a. Board Satisfaction Index evolution.
    b. Key performance indicators.
    c. Evaluation conclusions and review of Board Charter

Zen Appliances

The description of skills is omitted. The following information is provided:

1. Objectives as per Board Charter.
2. Evaluation of board performance and review of the Board Charter:
    a. Board Satisfaction Index evolution.
    b. Key performance indicators.
    c. Evaluation conclusions and review of Board Charter.

First Value Fund

The description of skills is omitted. The following information is provided:

1. Objectives as per Board Charter
2. Evaluation of board performance
    a. Board Satisfaction Index evolution
    b. Key performance indicators.
    c. Evaluation conclusions and review of Board Charter.

Example 1 - Mireia Care

Mireia Care is a company with an operating track record of 20 years. It is currently run by the founder, who is 45 years old. The company has its headquarters in the United Kingdom, with subsidiary offices on three other continents and a staff of approximately 500 people. The company's success is based on the quality and originality of its products and the maintenance of strong relationships with its customers who distribute to the end consumer.

The founder has a strong entrepreneurial drive and ambitious growth plans for his company, essentially to double in size over the course of four years. He also wants to devote more time personally to strategic thinking and the development of the company –especially M&A– and less to day to day operations.

He had some previous experience with a board, but it was not entirely satisfactory. Despite this fact, he clearly understood that his growth goals –as well as his own personal ones– placed him in a situation where he did not feel comfortable, believing that he did not have all the answers. He felt that a strong board would be able to provide him with the insights needed to give him a better chance of meeting both types of goals.

The author interviewed the owner and two key managers, as essential stakeholders, and studied an outdated –but relevant in its essence– three-year plan. The aim was to determine the *what* the board was for. The entrepreneur wanted a fiduciary board that assisted him in strengthening the institutionalization of the company and furthering its sustainability.

The author put the learnings from the interviews and documentation studied into a Board Charter -the guidebook for the board. It details the board's goals, the qualities the board members should bring to the table and all the process variables necessary to guide the functioning of the board.

In this case, the number of members established in the Charter was three, as this was the number considered necessary to add all the qualities described and generate appropriate team dynamics. The members were selected from an ample pool by comparing the qualities they brought with those necessary to add the expected value. Board members' profiles were strong, all of them being experienced C-suite managers. In broad terms,

they could be described as individually having particular expertise in marketing, sales and operations.

Mireia Care thus expects its Board of Directors to assist, and generate accountability for, senior management, in driving growth plans based on the following elements (detailed later in the company's Board Charter):

- International expansion.
- Opening new vertical market areas while maintaining the key elements of its added value (product originality and strong customer relationships).
- Optimizing the supply chain.
- Keeping a strong financial position.

Over time, the board is also expected to help the entrepreneur to identify his successor as well as his transition into a less executive role.

After the Board Charter, the reader will find a list of the qualities the author identified as needed by the board to meet the requirements of the Board Charter. Next, comes the information regarding the evaluation process. As previously stated, it is a combination of quantitative and qualitative parameters, which are finally translated into a grading system comprised of the elements described in the following subsections.

Board Satisfaction Index. This index is obtained through an online survey of all board members, following each meeting. The aim is to detect potential process improvements immediately; also, to understand the value that board members feel that being on the board adds to them personally -a key driver of their commitment to the board. The development of the Board Satisfaction Index is based on 9 questions. Using the survey output, all board participants are debriefed (by the author) to obtain their personal impressions about the meeting. They are asked directly about any issue which scored below 7. And they present their ideas about topics they consider relevant for future meetings. The per-meeting score is important, as well as its evolution over time. The aim is to immediately identify the impact of improvements (or deteriorations) in processes, in order to build upon them (or implement corrective actions).

In the case of Mireia Care, one year of Board Satisfaction Index scores are presented, and, of course, it continues to be tracked.

Key Performance Indicators. First comes the selection of a smaller number of objectives, taken from the Board Charter, to which the board will devote especial attention during the year. Then, the KPIs that will be used to measure them are assigned. At year-end -at the time of evaluation- the board's contribution to these KPIs is measured. The Executive Follow Up Document, which tracks individual board member's contributions as well as those of the whole board, is used for this purpose. The last step in the process is to determine -within a reasonable degree of accuracy- a range of values to be assigned to those contributions. This is usually done with the help of the company's CFO. The aim here is to determine a *reasonable* range, not to make the board "look good", thus there is little argument over the specific figures and the value assigned to the board. This value or range of values will be used to calculate the Return on Investment (ROI) for the board. All individuals involved clearly understand it as an approximation. Nevertheless, it serves the purpose of determining, in an objective manner, the value the board adds to the company. The conclusions of this process are presented in the *Conclusions of the evaluation and review of the Board Charter* section, which is next described.

Conclusion of the evaluation and review of Board Charter. This is where it all comes together. The calculation of board contributions, according to KPIs, is presented. The ROI is calculated using the cost of the board as the "investment" figure. The quantitative score is visually combined with the qualitative score of process variables, thus illustrating the overall performance of the board. Based on the evaluation results, the Board Charter is also reviewed, as are its process elements. Based on the qualitative and quantitative analysis of board performance and the potential evolution of objectives -they may have already been met or they may need to be changed- the objectives for the following year are then defined and agreed upon. If the changes agreed include modifying the board composition, this will be the time to consider it. All these issues are the subject of a board discussion.

1. Mireia Care objectives as per Board Charter. This section of the Board Charter details the objectives the board has to meet in order to further Mireia Care's strategic initiatives.

The Board should strive to:

1. Provide the CEO with a trusted sounding board to support him in making strategic and tactical decisions (with strategic implications).

2. Provide strategic advice in the areas of:
    a. International expansion (in this order)
        i. Region A country 1
        ii. Region A country 2
            - ROW (Rest of the World): Country expansion 1
            - Country expansion 2 (exploratory)

    b. Diversification into new business segments
        i. Men's product line
        ii. Women's products for mass market
        iii. Pet Care beyond country 2

    c. Vertical integration
        i. Incorporate proprietary raw materials or manufacturing processes
        ii. Face potential raw material scarcity
        iii. Improve costs

    d. Development of a coherent and cohesive global organization
        i. Organizational development
        ii. Generate an integrated global culture
        iii. Talent development

    e. Efficient production and delivery
        i. Develop capabilities and know-how in manufacturing
        ii. Develop a strong supply strategy: fast order-to-delivery process
        iii. Lean production methods with high use of technology in production

    f. Growth by acquisition
        i. Strategic reasoning of acquisitions
        ii. Integration of acquisitions

g. Optimal capital structure
    i. Finance top line growth
    ii. Prepare for potential acquisitions

h. Risk management, especially in emerging market operations

i. Top level succession planning.

3. **Mireia Care board member skills required**. This section – only included for this example – details the qualities that board members need to bring to the table in order to effectively add value to Mireia Care.

Board members' desired profile

Knowledge or skills	Members who have them
CEO experience in executing strong international B2B expansion in analogous industry	At least 1
CEO experience growing an international network of B2B sales affiliates	At least 1
COO experience in highly technified analogous industry	At least 1
COO experience in implementing lean production methods	At least 1
COO experience in analogous industry with diverse and geographically dispersed production centers	At least 1
COO experience in analogous industry with diverse and geographically dispersed logistical centers	At least 1
Experience growing an international network of production and logistics facilities	At least 1

COO Experience with production centers in emerging economies	At least 1
CEO/CMO experience in analogous B2B industry in Region A	At least 1
CEO/CMO experience in analogous B2B industry in Expansion Area 1	At least 1
CEO experience creating a strong global culture	At least 1
CEO experience managing a complex, geographically diverse company	At least 1
CEO/CSO experience creating strong innovative culture and organization in analogous industry	At least 1
CEO experience in growing business by acquisitions	At least 1
CEO experience in integrating acquisitions	At least 1
CEO/CFO experience in generating a strong capital structure for rapid growth	At least 1
CEO/CFO experience in preparing capital structure for growth by acquisition	At least 1
CEO/CFO experience in locating and structuring diverse international sources of capital	At least 1
CEO/CFO with strong understanding of macroeconomic trends	At least 1
COO experience in analogous industry with complex international value chains	Nice to have
COO experience in introducing high technology in the supply chain	Nice to have
CMO (including sales) experience in strong B2B international growth in analogous industry	Nice to have
CMO experience in creating a strong global B2B brand	Nice to have
CEO/COO experience in highly regulated B2B industry	Nice to have

3. Board performance evaluation and review of the Board Charter. This includes three elements: 3.a. Board Satisfaction Index evolution; 3.b. Key performance indicators; 3.c. Evaluation Conclusions and review of Board Charter.

3.a. Board Satisfaction Index evolution

This is the first part of the evaluation process and is a combination of post-meeting surveys administered online and an annual review of score evolution. Both the post-meeting results and the annual evolution are the subject of individual conversations with board members, to understand their scoring, particularly if they score 7 or below in any item. The key objective of this survey is to follow process variables and introduce improvements immediately, when some part of the process is not functioning well. It is also intended to understand the value that board members feel that being on the board adds to them personally; this is a key driver of their commitment to the board, as noted earlier.

The average score for the year shown here was 8,73 over 10, with an increase in the first two meetings and a slight decline in the third and fourth. In this particular case, the cause for the decrease –a lower rating on the quality and quantity of the information provided– did not merit any significant changes in process; however, it did justify paying special attention to the quality of the information provided, especially since it was generating a downward trend in the per-meeting process scores. Not yet worrisome but worth keeping under observation is the slight decline in the scores of the value each board member perceived from taking part in the meeting. If this score were to decrease, it would demand an in-depth conversation with board members to gain a strong understanding of their scores and whether any action should be taken.

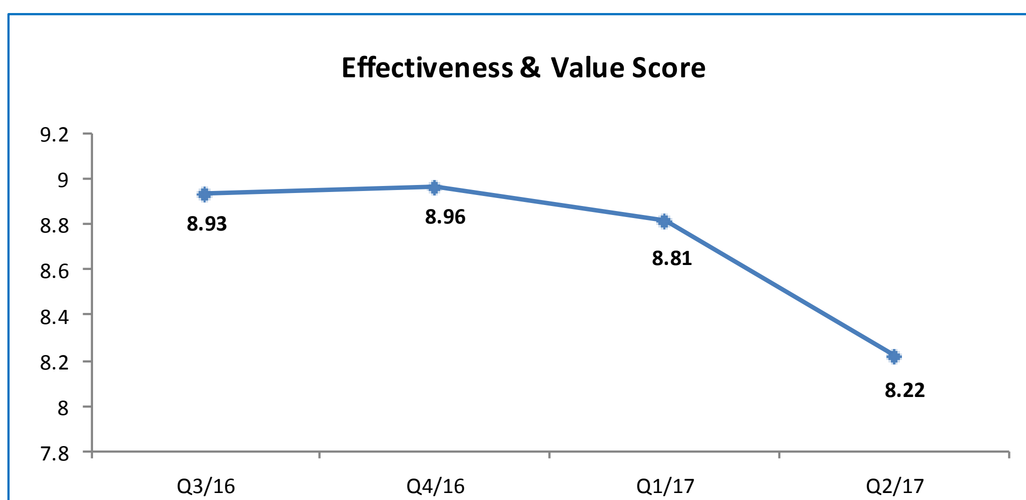
Post-meeting survey

1	I feel that this specific board meeting was highly effective
2	I feel that the board meeting was facilitaded to foster discussions that was helpful to the company
3	I feel that this board meeting discussion was highly strategic
4	I feel that the board discussion was direct, open and honest
5	I feel that ALL of the board members were completely prepared for this board meeting
6	I feel that the management team was completely prepared for this board meeting
7	I feel that the board packet contained exactly the right amount of information for the board members to be able to understand how to help the organization
8	I feel that the board information was sent out on time and easily accessible
9	I feel that this board meeting provided me with a high degree of value

Board Satisfaction Index evolution

Subject	2016-17				
	Q3/16	Q4/16	Q1/17	Q2/17	Avg
Meeting Effectiveness	9.50	9.50	9.50	9.00	9.38
Facilitation	9.50	9.50	9.50	9.00	9.38
Strategy	9.00	9.33	9.00	7.67	8.75
Open and Honest	9.67	9.67	9.33	8.67	9.34
Preparation of the Board Members	8.67	9.00	9.33	8.33	8.83
Preparation of the Company Mgmt.	9.00	8.67	8.00	8.00	8.42
Quality and Quantity of Information	8.67	7.33	7.67	7.67	7.84
Documentation sent on time	7.00	8.33	8.33	7.67	7.83
Value of the meeting for member	9.33	9.33	8.67	8.00	8.83
Year Average	8.93	8.96	8.81	8.22	8.73

Effectiveness & value score



Q3/16	8.93		
Q4/16	8.96		
Q1/17	8.81		
Q2/17	8.22	**YEAR AVERAGE**	**8.73**

3.b. Key performance indicators

This is the second part of the evaluation process. It reflects objectives set at the beginning of the year based on those included in the Board Charter. Some of the objectives may not be reachable or measurable in a single year. Along the year, outcomes are tracked using the Executive Follow Up Document, which monitors

contributions of individual board members and the board as a whole. It also keeps track of action items agreed. At the time of evaluation, the outcomes achieved are listed and a method is found to assign a value to them, in order to provide a quantitative range of the impact that the board has generated for the company, as already mentioned above. In a subsequent section, this number will be compared to the cost of ("investment in") the board, thus the ROI is estimated as a multiple of the cost incurred for implementing and maintaining the board.

Expected outcome

Expected outcome
Drive top line growth within expected profitability parameters
Execute and Integrate first acquisition
Geographic growth
Develop a coherent and cohesive global organization
Achieve marked increase in product innovation
Solidify an extraordinary Marketing and Sales process
Set long term capital structure strategy

To evaluate the achievement of the above expected outcomes, the following targets were agreed:

- Inorganic growth via acquisition of companies within the industry in:
  - Country 1
  - Country 2
- Organization:
  - Redefinition of the organizational structure to meet the company's growth for the next 3 years
  - Recruitment of a trustable expatriate Executive, 'controller' for country 3
  - Recruitment of a new General Manager for country 4
  - Create a quarry of possible expatriates
- Generate cash for shareholders. Objective: €5M
- Leverage the sales/revenue growth by fulfilling the objective parameters for margins, profitability and balance sheet structure described in the Business Plan.
- Improve EBITDA/debt ratio.

- Meet plans to make the company attractive for a financial partner to join.
- Search for a financial partner to boost growth and achieve a value above XX times EBITDA
- Develop new products by using existing technologies so that new business is generated (for instance new packaging).

Metrics and assessment methods were established using both KPIs (quantitative) and questionnaires (qualitative) to quantify the outcome for each objective. The resulting outcomes are shown in the table presented here, indicating the objectives pursued, the contribution of the board that is being valued, through what KPI it was estimated and based on what data. Finally, the calculation of the value attributed to the board is noted for use in the next described following step.

Board contributions and their value impact

<table>
<tr><th>Objective</th><th>BoD Contribution</th><th>KPI</th><th>Base Data for Impact Value</th><th>Work Out (Value-Impact)</th></tr>
<tr><td>Set long term capital structure strategy & Geographic Growth. Financial Partner for inorganic growth</td><td>Focus on the margins, expenses and balance structure control and improvement . Make the company attractive for a financial partner and achive price over the target price of XX on EBITDA</td><td rowspan="2">The company obtained a new financial partner. In this case, KPI used was the difference between the initial company value target price and the final price paid for the new financial partner due to EBITDA improvement. We only consider effects on EBITDA as a consequence of a better control of expenses and margins and better net financial position.</td><td rowspan="2">Difference between purchase-target price. % improvement in EBITDA since board recommendations.</td><td rowspan="2">Ebitda improved by €0.5 M and the net financial position by €1M . The EBITDA multiplier was finally 5, with which the impact on the absolute value of the company was estimated at €3.5M ((€0.5M * 5) +€1 M). The impact on the stockholder's free cash was proportional to the shares sold , therefore 49% * 3.5 = €1.7M</td></tr>
<tr><td>Set long term capital structure strategy. Free cash for stockholders, €5M</td><td>The BoD had a very prominent role in negotiations with the new partner</td></tr>
<tr><td>Execute and Integrate first acquisition.Inorganic Growth in Country 1 within 2 years time from decision</td><td rowspan="3">Recruiting of a Corporate Executive, replacement of the CFO and recruitment of an expat financial controller for country 3 - guidance to these executives by individual board members</td><td>KPI was designed to calculate the impact on the consolidated profit & loss account of the group due to a reduction of strategic target time of an acquisition in country 1 (Target time was set in 2 years and finally M&A operation was closed in 12 months)</td><td>Days between the beginning of the operation to the purchase agreement and outcome of the subsidiary in the meantime.</td><td>Only the impact due to the acceleration time of the acquisition process has been considered, we can not calculate the impact or effects of the non-acquisition that would probably have occurred if no changes in the organizational structure were done.The acquisition was completed in 12 months. € 300K estimated impact on the results of the group</td></tr>
<tr><td rowspan="2">Develop a coherent and cohesive global organization.Redefinition of the organizational structure to meet the company's growth for the next 3 years according to BP</td><td>Evolution of % of financial expenses as a % of sales (consolidated group accounts)</td><td>Financial expenses, amounts and % on sales for the 12 months since the recruitment of the nex Executive</td><td>Reduction by 0.10 % on the cost of external financing as a % of sales. Absolute value impact : € 300K (effect of market interest rates considered)</td></tr>
<tr><td>Results of new management team.New financial controller in country 3. KPI used was the variation of profit and loss account of the subsidiary in country 3 during 1 year from the kick off date of the new financial controller.</td><td>Operating account in Country 3 before the recruitment of the controller and one year later</td><td>The calculated impact took into account only the reduction of operating and structure expenses resulting from the direct intervention of the new financial controller. (Improvements in supply chain policy, labor costs reduction, new prices obtained from suppliers...) The impact was estimated at €100K</td></tr>
<tr><td>Achieve marked increase in product innovation. Development of new products by using existing technologies</td><td>Providing rationale and process to accelerate innovation decisions (new products & new packaging)</td><td>Margin of sales contribution due to new products launched to the market and new packaging used</td><td>Sales and margins of new products and transport savings due to new packaging (15% of the estimated value generated over 3 years is attributed to the board)</td><td>€1,5 M of estimated impact</td></tr>
</table>

3.c. Evaluation conclusions and review of Board Charter

This is the conclusion of the board evaluation for a given year. The calculation of the value impact of board contributions according to the KPIs is shown and an ROI is estimated, using the already explained method. The quantitative impact is then visually combined with the qualitative process scores to illustrate the overall performance of the board.

At this time, with the results and analysis of the evaluation and the possible evolution of objectives, the goals of the Board Charter are reviewed, together with the process elements defined in the Charter. The objectives for the following year are then considered in a board discussion as are any changes in the process elements (including board composition).

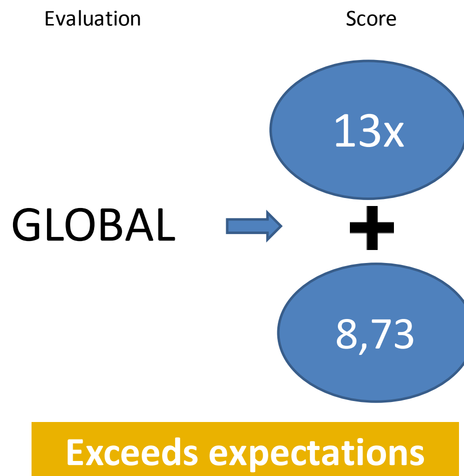
The estimated economic impact of its board contributions to Mireia Care for the year is **€ 3.9M** split as follows:

- Incorporation of the financial partner: €1.7M
- Accelerating inorganic growth: €0.3M
- Enhancements to the organization: €0.4M
- Accelerating innovation decisions: €1.5M

- Economic cost of board: €0,3 M
- **ROI calculation: 13 additional Euros of profit have been obtained for each Euro invested in the Board (13x).**
- The period considered for impact calculations is 1 year, unless otherwise noted.
- The assessment does not include the impact of those contributions made by the board that are too recent or not yet implemented.

The chart presented below summarizes the evaluation results:

Evaluation Chart



Both these scores are high, with the return multiple in excess of 10x and the process score above 8. The board performed "exceeding expectations". However, as noted in 3.a., the scores regarding quality of information and value of the board for board members showed a downward tendency, consequently demanding special attention. As a result of the evaluation conversation, a few changes were made to the Board Charter:

- Some of the objectives originally in the Charter were altered, specifically those related to geographic expansion, where one of the target regions was eliminated as a result of board discussions during the year.

- Task forces were created for specific projects which the company was embarking upon. This was the direct result of asking about the value of the board for the board members themselves. They felt the company founder acted at such speed that the quarterly meetings sometimes felt scarcely adequate to help him with these matters. Initially, an increase in meeting frequency was considered, but the Task Force solution was finally adopted, with only some members serving on each task force. This solution allowed board members to serve on the task forces where they could add most value. Besides, it did not require an increase in the number of meetings of the whole board, thus optimizing board members' time. This mechanism was also added to the process section of the Charter.

Example 2 - Zen Appliances

Zen Appliances is a European home appliances manufacturer and retailer. It is a family owned business with a history of more than 45 years. Its strategy is based on the design, production (outsourced), sale and financing of home appliances. The number of employees stands at 1,000. It is owned by three siblings and run by the youngest brother, who has now been the CEO for 20 years. The other two siblings are not directly involved in the business, but are in close contact with it, as the CEO keeps them well and frequently involved.

The CEO has presided over a period of strong growth for which he is largely responsible (and given credit for). However, because he was brought into the business by his mother (the founder), early in his career, he had little opportunity to complete advanced academic training, such as a Master's degree. Although he is evidently an expert manager, he is keenly –sometimes overly– aware of his shortcomings.

In 2012 a strategy consultant was brought in to help chart the next stage of high growth, which called for tripling the size of the company over 10 years. The CEO felt that some of the organizational and business model changes proposed made sense, but he also thought they took him beyond his areas of greatest competency. Furthermore, as the children of all three siblings were growing older, the need to generate greater transparency and accountability in the company was felt by the three of them. They clearly saw the need to begin institutionalizing governance. Creating a board was suggested by the eldest sibling as a means to help with both goals. They did not have any previous experience with boards, but had heard too many negative opinions about them. Thus, they wanted to ensure their board would provide support for the CEO and add value to the company.

To assist Zen Appliances in creating their board, the author reviewed the strategic plan derived from the consultant's work and interviewed the three siblings, as well as reviewing the CEO's six direct reports. The aim was to determines *what* the board was intended for. This analysis essentially confirmed the view described in the previous paragraph.

As in example 1, the author used the learnings from the interviews and the strategic plan analysis to propose a Board Charter. The document detailed the board's goals, the

qualities the board members should bring to the table and all the process variables necessary to guide board functioning.

In the case of Zen Appliances, the number of members established in the Charter was four. This was the number deemed necessary to add all the qualities defined and to generate appropriate team dynamics, particularly because the company comprises two very distinct businesses, *selling* and *financing* the end-consumers' purchases. The members were again selected from an ample pool by comparing the qualities they brought with those necessary to add the expected value. All board members had CEO or COO experience in areas similar to those where they were expected to add value, most being currently engaged in a top level executive job. Board members' profiles were strong. In broad terms, they had special expertise in retail operations, in selling financial products for purchasing consumer goods, in financing operations both of retailers and financial companies as well as in talent development. Furthermore, two of the members had experience in family business, one in his own family company and the other as an external CEO of a family-owned business.

The company, therefore, has an ambitious growth plan. The owner feels it is taking him beyond his comfort zone and he expects the board to contribute to:

- Driving its short and long-term expansion plan.
- Ensuring the company has the appropriate capital structure to finance growth.
- Creating accountability and transparency on the part of the management team.
- Ensuring the company has in place the right organizational structure and the necessary talent to face growth plans.

The type of board created was a non-fiduciary advisory board, as the three siblings felt no need to change the balance of power in decision making, but did want expert advice on the matters above explained.

The Zen Appliances board has been in operation now for more than three years. Some changes in composition have taken place over this period to resolve a conflict of interests arising with one of the board members. Some changes have been implemented as well in Board Charter objectives.

Board Satisfaction Index. This index is obtained and used in the same way as detailed in the previous example (Mireia Care).

In the case of Zen Appliances, three years of Board Satisfaction Index scores are presented, although the graph included is limited to 2016, given the fact that the index evolution has been fairly steady. It continues to be tracked at the time of the writing of this dissertation.

Key Performance Indicators. These indicators are obtained and used in the same way as detailed in the previous example (Mireia Care).

Although an evaluation process like the one proposed was followed in each of the board's three years of operation, only the data for 2016 is shown for the purposes of this example.

The conclusions are presented in the **Evaluation conclusions and review of the Board Charter** section, which is next included.

Evaluation conclusion and review of Board Charter. The quantitative and qualitative scores of the board are calculated in this section in the same way described in the Mireia Care example. Here too, all aspects of the evaluation are the subject of a board discussion.

1. Zen Appliances objectives as per Board Charter. The objectives for 2016 as per the latest revision of the Board Charter (at the time of the 2015 evaluation) were defined for four crucial areas as follows:

- Establish and achieve the most appropriate funding sources.
- Refine, validate, and execute the sales strategy that will generate the expected growth.
- Ensure that the organization has the necessary talent to achieve growth.
- Ensure that the organization is structured to support and assimilate growth.

Objectives and KPIs were established for each group:

Objectives by group

Group	Area	Objective	
Financing	Financing	Establish financing sources for the first three years of growth	Help establish a sustainable financing model
Sales Strategy	Sales	Reach yearly sales objectives for the three first years	
	Domestic Expansion	Reach new openings yearly objectives	
	International Expansion	Reach new openings yearly objectives	
Organization	People	Help Management Team to recruit the human resources needed for growth in the next six years	Promote metrics such as "best place to work" to allow talent retaining
Structure	Business Structure	Help Executive Team in the consolidation of a new business structure	Give each business unit the tools to allow them to work independently from one another

In each of the board meetings the board members' contributions were compiled and classified according to each objectives group and using the Executive Follow Up Document.

2. Board Performance Evaluation and review of the Board Charter. This includes three elements: 2.a. Board Satisfaction Index evolution; 2.b. Key performance indicators; 2.c. Evaluation conclusions and review of the Board Charter.

2.a Board satisfaction Index evolution

This is the first part of the evaluation process and is a combination of post-meeting surveys administered online and an annual review of the scores evolution. Both the post-meeting results and the annual evolution are the subject of conversations with the board members individually, to understand their scoring, particularly if they score an item at 7 or below. The key objective of this survey is to follow process variables and introduce improvements immediately, if some part of the process is not functioning appropriately. It is also intended to understand the value that board members feel that being on the board adds to them personally, since this is a key driver of their commitment to the board.

The average score for the year was 8.63 over 10, holding relatively steady over the course of the four quarters, and similar to that of previous years. Despite the high overall score, the item related to quality and quantity of information and preparation of the company management for the board meetings showed a decrease during Q2. In this case, the cause was related to the work of an executive, one of the CEO's direct reports, in preparing the board meetings, which was deemed only satisfactory. It was corrected in a subsequent meeting in which she also took part, and the score evolved accordingly. The scores show that the significant effort to keep the process of the board well aligned with the needs of the company as they evolve is effective. Even changes in board composition that took place in 2015 and 2016 have not significantly altered the scores. Particularly relevant in this sense is the value derived from the meeting by board members, which holds reasonably steady over the 12 quarters observed.

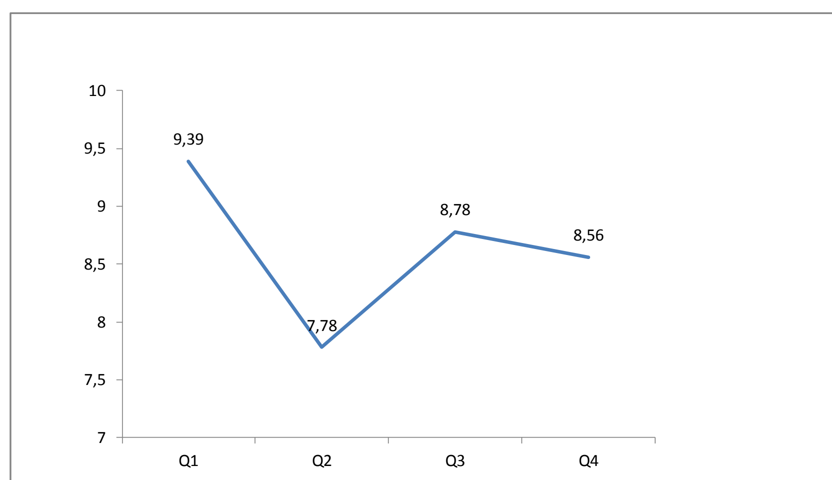
Post-meeting survey

1	I feel that this specific board meeting was highly effective
2	I feel that the board meeting was facilitaded to foster discussions that was helpful to the company
3	I feel that this board meeting discussion was highly strategic
4	I feel that the board discussion was direct, open and honest
5	I feel that ALL of the board members were completely prepared for this board meeting
6	I feel that the management team was completely prepared for this board meeting
7	I feel that the board packet contained exactly the right amount of information for the board members to be able to understand how to help the organization
8	I feel that the board information was sent out on time and easily accessible
9	I feel that this board meeting provided me with a high degree of value

Board Satisfaction Index evolution

Subject	2014						2015					2016				
	1	2	3	4	5	Avg	1	2	3	4	Avg	1	2	3	4	Avg
Meeting Effectiveness	8,50	7,75	9,00	9,00	8,00	8,45	8,50	7,50	10,00	9,00	8,75	9,33	7,50	9,00	7,00	8,21
Benefit for the Company	9,00	7,75	8,75	9,00	9,00	8,70	9,00	7,00	9,25	9,00	8,56	9,67	9,00	9,00	8,00	8,92
Strategy	9,00	7,00	9,50	8,00	8,00	8,30	7,50	7,50	9,75	9,00	8,44	10	8,50	9,00	8,00	8,88
Open and Honest	9,50	9,50	9,25	10,00	9,00	9,45	9,50	9,50	9,25	9,00	9,31	10	9,00	9,00	10,00	9,50
Preparation of the Board Members	8,50	8,50	10,00	9,00	9,00	9,00	9,75	8,00	10,00	9,00	9,19	9,67	9,00	9,50	9,00	9,29
Preparation of the Company Mgmt.	7,75	5,75	8,00	9,00	9,00	7,90	9,00	7,50	9,75	8,00	8,56	8,67	5,50	8,00	9,00	7,79
Quality and Quantity of Information	7,00	5,75	8,50	8,33	7,00	7,32	9,50	7,50	8,50	9,00	8,63	8,33	6,50	9,00	8,00	7,96
Documentation sent on time	10,00	7,75	8,50	10,00	8,00	8,85	9,50	7,00	6,75	9,00	8,06	9,5	7,50	7,50	9,00	8,38
Value of the meeting	9,50	7,50	9,50	9,33	8,00	8,77	9,25	7,50	9,50	9,00	8,81	9,33	7,50	9,00	9,00	8,71
Year Average	8,75	7,47	9,00	9,07	8,33	**8,53**	9,06	7,67	9,19	8,89	**8,70**	9,39	7,78	8,78	8,56	**8,63**

Effectiveness & value score



Q1	9,39
Q2	7,78
Q3	8,78
Q4	8,56

Year Average	**8,63**

2.b. Key Performance Indicators

KPIs are the basis for the second part of the evaluation process, reflecting objectives set at the beginning of the year based on those included in the Board Charter. As mentioned earlier, some of the objectives may not be reachable or measurable in a single year. Along the year, outcomes are tracked using the Executive Follow Up Document. At the time of evaluation, the outcomes achieved are listed and a method is found to assign a value to them, thus obtaining a quantitative range of impact generated by the board for

the company. In the final section (2.c.) of the evaluation, this figure will be compared to the cost of ("investment in") the board, in order to calculate the board's ROI, a multiple of the cost incurred for implementing and maintaining the board.

The Zen Appliances' board defined for itself two main areas of work in line with the objectives set out in the board charter:

- Define an alternative capital structure to the one in place for the last two years. The objective was for the new structure to be in place by year end. This had two corollary objectives.
    - Drive the preparation of Receivables as a guarantee for additional funding.
    - Reinforce bank relationships –and explore new ones– to ease the approval of new financing facilities.
- Redefine pricing policy to ensure it adequately reflects improvements in the product offering implemented over the past two years.
- Reevaluate the expansion strategy to ensure its sustainability and the maximization of profit potential. Decide between "oil stain" strategy and going far from HQ into a high-potential, but geographically distant, market.

Given the scope of the key objectives defined, the board felt two others could be left pending for the time being. These were:

- Ensure that the organization has the necessary talent to achieve growth.
- Ensure the organization is structured to support and assimilate growth.

This is not to say the board ignored these subjects, but rather that it dealt with them reactively and in a tactical fashion. Because the board was acting defensively on these issues, no significant profit generating contributions were registered.

Metrics and assessment methods were established to quantify the outcomes of the first two objectives (financing and sales strategy). The results are shown in the table below. It records the objective pursued, the board contribution that is being assessed, with what KPI it was valued and based on what data. Finally, the estimation of the value attributed to the board is noted for use in the next step (Evaluation conclusions and review of Board Charter).

Board contributions and their value impact

Group 1: Financing

BoD Contribution	KPI	Base Data for Impact Value	Work Out (Value-Impact)
New capital structure. Implement a new and specific financial model according to each Business Unit needs, not a single model for the whole business. Improve control of receivables portfolio. Use receivables to substitute bank guarantees offered in assets (basically real estate and funds). Assets released can be used to increase financial resources, profitability or to invest in new business opportunities	Profitability obtained in absolute value from new investments made with liberated capital	Total amount of liberated capital; profitability of free cash invested	Average annual return on new investments using liberated capital = 8%. Calculated absolute value impact = **€ 600,000**
Improve relationships with banks and credit institutions. Open doors to add new banks and credit institutions. Improve the management and quality of financial and economic information. Proposal and support to CFO replacement process	Percentage of financial expenses on sales. Calculation of savings	Detail of financial expenses evolution (one-year analysis) amounts and percentages on sales.	Reduction of 0.25 % in the financial expenses on sales. Impact in absolute value: **€ 500,000**

Board contributions and their value impact

Group 2: Sales Strategy

BoD Contribution	KPI	Base Data for Impact Value	Work Out (Value-Impact)
Redefinition of pricing strategy and standardization of sales process. Apply a new policy of margins. Clarify differences between price and value. (for all products and services of the company) - all resulting in a new pricing policy	Analysis of sales evolution in units and prices correlated with the evolution of margins by categories of products in shops where pricing policy has been applied and shops where new pricing policy was not yet applied.	Sales and margins obtained by products without significant price increases versus sales and margins in products/categories with significant increases. (Significant increase> 7% in one year). Calculation of the margin obtained from the new pricing policy	**€1M** was the estimated impact, on the profit and loss account of the group due to an increase in the contribution margin (in absolute value) as a result of the new pricing policy applied
Concentrate retail expansion strategy on an "oil stain" approach - closer to HQ and with a big unexploited potential. Postpone expansion into distant territory, even if it seems to have big potential	Difference between the estimated net present value of profit in the expansion project far away from influence area and profit obtained from the new shops opened in areas close to HQ. (Special attention to transport and freight savings costs).	Estimated Net present value of profits from the expansion strategy project (expansion in far areas of influence of the company) Estimated profits obtained from new shops near influence area. Additional profits obtained by the differential of resources dedicated to investment in far away areas versus investment finally used in nearby areas. (The planned investments planned in far away expansion areas were higher than investment finally done in near ones)	Estimated impact of **€5M** on the profit and loss statement as a result of the strategic change in the expansion policy. 50% attributed to baord action = €2.5M
Drive and support to the existing project of international expansion in Country X. Support the CEO of the Country X. Test a new sales processes in country X, adjusted to local needs. Decentralization of functions and decision-making, bringing it closer to the consumer	Difference between estimated loss before board action and real profits 12 months after board action	P&L data of subsidiary in country Xç	Subsidiary X went form losses to profits. The differential profit obtained was **€1M**. 30% of this is attributed to board action = €300K

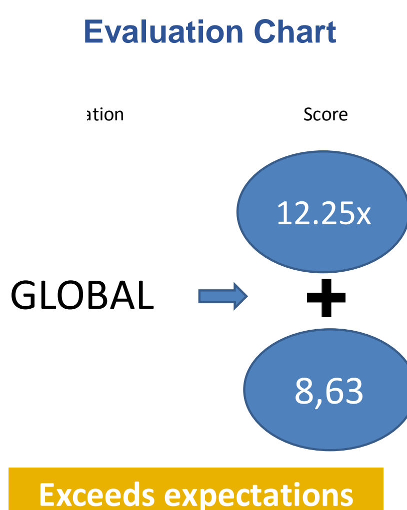
Work was done by the board on the Organization and Group Structure objectives, but it was partial and no value is yet attributed to that action.

2.c. Zen Appliances' evaluation conclusions and review of Board Charter

The impact of the Advisory Board contributions for the evaluated period is estimated at **€4.9 M** in additional profit as a result of board action and split as follows:

- Financing: €1,1 M in additional profit
    - €600 K in profit from investments using freed up capital
    - €500 K in profit from a reduction in financial expenses (after variations in the market rate were considered)
- Sales Strategy: €3.8 M in additional profit
    - €1M in profit resulting from improvements in the pricing strategy
    - € 2.5 M in profit resulting from going for an "oil stain" strategy, based on analyses revealing growth potential close to HQ
    - € 300 K in profits resulting from changes made in international expansion, in particular, organizational and marketing strategy contributions that helped turn around country X
- Economic cost of the board: €400 K
- **ROI: 12.25 € of additional profit have been obtained for every € invested in the Board.**
- The period considered for impact calculations is 1 year, except if otherwise noted.
- The assessment does not include the impact of those contributions made by the board that are too recent or not yet implemented.

Below you will find the table summarizing the evaluation results:



Both these scores are high, with the return multiple in excess of 10x and the process score above 8. The board performed “exceeding expectations”.

The year-on-year evaluation and review of the Board Charter led to an adjustment in the latter: to place capital structure and sales and expansion objectives under observation for the following year, to ensure that changes made are sustainable. No additional objectives were included, as two important ones had been left pending, as noted above. Nevertheless, special emphasis is placed on the objective of ensuring the organization has the talent needed to sustain growth, and to ensure the cohesion and strength of the top executive team (direct reports to the CEO). No changes to board composition were required by the modifications to the Charter. No changes were made in board process.

Example 3 - First Value Fund, a private equity fund

First Value Fund is a private equity fund based in Luxemburg and owned primarily by three investors who founded it in 2000 and hold most of the shares, while a minority stake is distributed among several smaller investors who are family and friends of the first three, and invested in the fund in, or shortly after, 2010. The fund has over €150 M under management. The portfolio is composed of a core investment in the financial services industry, a number of real estate investments (as will be later explained) and several other smaller investments. A substantial amount is held in cash and, more frequently, invested in liquid assets quoted on international exchanges. All of the funds come from the shareholders. A formal (fiduciary) board structure is in place, although only the three main partners are members. The rest of the shareholders receive official information once annually, and informally through conversations with the partners they have most direct contact with.

First Value is managed by one of the three main partners although the other two are closely involved in the business. The CEO, in close cooperation with the other two key partners, has run the fund successfully to date, preserving and increasing the base capital and achieving returns similar or better than those of comparable private equity funds. Most of the investments have been opportunities found through the three partners' networks, who have extensive contacts in the financial services industry due to their previous occupations. The real estate investments were also opportunities found through their networks as well, in this case though from other high-net-worth individuals they were acquainted with. Some of the smaller investments came from the minority shareholders.

The CEO is supported by a small team of top managers who are in charge of day to day operations; they perform analysis and follow up the companies the Fund has invested in. One of them is responsible for the daily management of the liquid asset portfolio. Although these managers have been increasingly involved in decision-making regarding potential investments, they still rely heavily on the CEO for decisions and deal sourcing. The CEO in turn consults his partners essentially on deals that he deems to be attractive opportunities.

First Value boasts an excellent performance in the recent past and looks forward to continued growth. However, the CEO believes that, in the medium-term, the goal

should be to rebalance the portfolio to reduce geographic exposure to one market and to re-evaluate some smaller investments. He also believes their concentration in the financial services industry is excessive and wants to consider the possibility of including one or two major investment areas intended to be "core" in the future portfolio. He is a most dynamic individual constantly looking for, and being invited to, new investment opportunities. He has a hard time saying no these proposals, if they come from the right people. To some extent, he fears that, if he says no, he will not be invited to the "next deal". However, the smaller shareholders have voiced some concern (nothing serious) over the CEO's excessively personal management of the fund. Paradoxically, the CEO is not very interested in the day to day operations which he considers somewhat tiresome. Additionally, he believes that he adds substantial more value sourcing and executing deals, which is also what he most enjoys. He is, nevertheless, sensitive to the feelings of the smaller shareholders, whom he deeply respects.

As a result of the above, in 2015 the CEO and his partners decided that it was time to begin formalizing some key processes within the company, beginning with its governance. An additional concern of the smaller shareholders was what would happen to the fund if something was to befall the CEO. One of the three partners contacted the author in 2015 to assist them in establishing a board for First Value Fund.

To that end, the author of this dissertation interviewed all shareholders to understand their perspectives regarding what they wanted from the board. He also interviewed the three partners, with particular time devoted to the CEO, to understand the business (no formal business plan was in place) and the investment strategy followed to date (explained above). He also interviewed two key direct reports of the CEO. All this was done with the aim of establishing *what* the board was for and confirmed that it should:

- Help to define a more structured and formalized investment strategy to preserve and increase the Fund's base capital and to continue to yield excellent returns.
- Help to define key procedural aspects the Fund should put in place, streamlining and institutionalizing the decision-making process.
- Act as sounding board for strategic decision-making.
- Drive the search for a new "core" investment.
- Help to establish a succession plan for the CEO.

- Provide increased accountability and transparency in the governance of the Fund.

As in the previous examples, the author used the learnings from the interviews and the analysis of the relevant documentation to propose a Board Charter. The document detailed the board's goals, the qualities the board members should bring to the table and the process variables necessary to guide the board functioning.

In the case of First Value Fund, the number of members established in the Charter was three, as this was the number considered necessary to add all the desired qualities and generate the appropriate team dynamics. The members were again selected from an ample pool by comparing the qualities they brought with those necessary to add the expected value. All board members had CEO or COO experience in financial services or managing partner experience in private equity. Two of them still held a top level job. In broad terms, they had special expertise in financial services and in private equity fund management. Furthermore, one of them had been the CEO of a fund she co-owned.

The type of board created was a non-fiduciary advisory board, as the three main partners did not want to alter the balance of power of the existing board. Nevertheless, they did recognize the need for greater transparency and accountability in their governance, and for strengthening the decision-making processes to reduce dependency on the CEO.

The First Value Fund board has been in operation for one and a half years.

Board Satisfaction Index. This index is obtained and used in the same way as detailed in the first example (Mireia Care). In the case of First Value Fund, one year of Board Satisfaction Index scores are presented. The index continues to be tracked at the time of writing this dissertation.

Key Performance Indicators. These indicators are obtained and used in the same way as detailed in the first example (Mireia Care). Conclusions are presented in the **Evaluation conclusions and review of the Board Charter** section, included below.

Evaluation conclusion and review of Board Charter. The quantitative and qualitative scores of the board are calculated in this section in the same way described in the first example (Mireia Care). Here too, all aspects of the evaluation were the subject of a board discussion.

1. Objectives as per the Board Charter

This section of the Board Charter details the objectives the board should meet to further First Value Fund's strategic initiatives:

1. Define a strategy for the medium and long-term portfolio based on:
    a. maintaining and increasing base capital
    b. preserving and increasing the performance of the portfolio
    c. rebalancing the portfolio by reducing the exposure to countries A and B.

2. Streamline procedures for short-term decisions, with special emphasis on those with strategic impact in the long term.

3. Act as a strategic decision-making partner in consonance with the strategic thinking of the management team. In particular:
    a. create a structured processes and policies for investment decision-making
    b. act as advisors to the Investment Committee to assist in the investments decision process.

4. Track the on-time achievement of key strategic initiatives.

5. Act a "sounding board" to the CEO regarding strategic decision-making and strategic impact tactics.

6. Assist in planning the expansion into new markets
    a. Region 1
    b. Region 2
    c. Region 3

7. Drive the search for one, or maximum two, new significant investment areas to create a new "core" for the Fund's portfolio.

8. Provide investment opportunities to improve the average profitability of the last 3 years, for target areas, in alignment with the core areas.

9. Contribute to increase the Fund's visibility to create an investors network.

10. Structure a succession plan for the CEO

2. First Value Fund evaluation of its board performance and review of the Board Charter

This includes three elements: 2.a. Board Satisfaction Index evolution; 2.b. Key performance indicators; 2.c. Evaluation conclusions and review of Board Charter.

2.a. Board Satisfaction Index evolution

As earlier explained, this is the first part of the evaluation process combining post-meeting surveys administered online and an annual review of scores evolution. Both the post-meeting results and the annual evolution are the subject of conversations with board members individually. The aim is to understand their scoring, particularly if they score an item at 7 or below. The key objective of this survey is to follow process variables and introduce improvements immediately, if some part of the process is not functioning appropriately. It is also intended to understand the value that board members feel that being on the board adds to them personally -a key driver of their degree of commitment to the board.

The average score for the year was 8.64 over 10, which is high. However, the evolution was somewhat uneven, with the index showing a strong dip in the second quarter. Analyzing the scores of individual items, it became clear that the lack of habit in preparing formal documentation was not easily overcome. Board members rated the quality and quantity of information at 6 (barely over satisfactory) in Q2 and only slightly higher, at 7, in the two subsequent quarters. The information quality in this board continues to require additional effort at this time. Also, in Q2, the documentation

reached the board only two days in advance of the meeting. This was quickly corrected and the scores for that item consequently improved. However, as the downward tendency in Q4 shows, it is still an issue that demands vigilance and ongoing management.

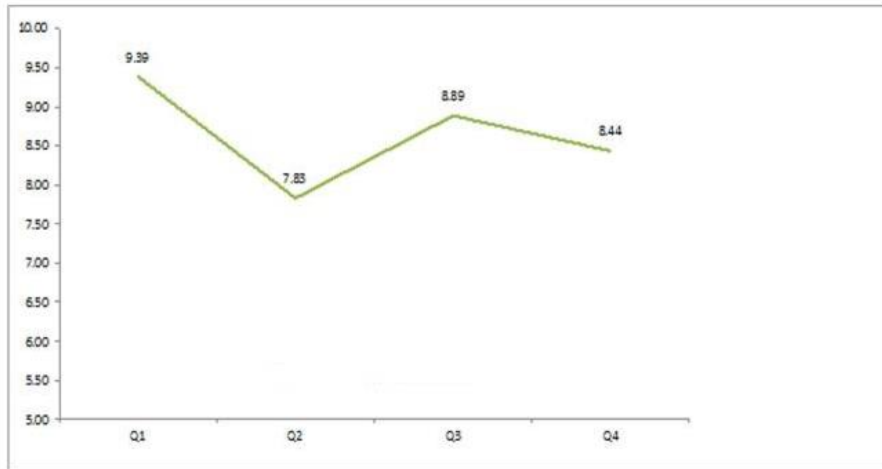
Post-meeting survey

1	I feel that this specific board meeting was highly effective
2	I feel that the board meeting was facilitaded to foster discussions that was helpful to the company
3	I feel that this board meeting discussion was highly strategic
4	I feel that the board discussion was direct, open and honest
5	I feel that ALL of the board members were completely prepared for this board meeting
6	I feel that the management team was completely prepared for this board meeting
7	I feel that the board packet contained exactly the right amount of information for the board members to be able to understand how to help the organization
8	I feel that the board information was sent out on time and easily accessible
9	I feel that this board meeting provided me with a high degree of value

Board Satisfaction Index evolution

	2016				
Subject	1	2	3	4	Avg
Meeting Effectiveness	9.00	8.50	9.50	9.00	9.00
Benefit for the Company	10.00	8.00	9.50	9.00	9.13
Strategy	9.00	8.00	8.33	8.50	8.46
Open and Honest	10.00	9.33	9.67	9.00	9.50
Preparation of the Board Members	9.50	8.33	9.00	8.50	8.83
Preparation of the Company Mgmt.	8.50	8.67	8.67	9.00	8.71
Quality and Quantity of Information	8.50	6.00	7.00	7.00	7.13
Documentation sent on time	10.00	4.67	9.00	7.50	7.79
Value of the meeting	10.00	9.00	9.33	8.50	9.21
Year Average	9.39	7.83	8.89	8.44	8.64

Effectiveness & value score



Period	First Value
Q1	9.39
Q2	7.83
Q3	8.89
Q4	8.44

2.b. Key Performance Indicators

This is the second part of the Evaluation process, reflecting objectives set at the beginning of the year based on those reflected in the Board Charter. As noted earlier, certain objectives may not be reachable or measurable in a single year. During the year, outcomes are tracked using the Executive Follow Up Document. At the time of evaluation, the outcomes achieved are listed and a method is found to assign a value to them, this provides a quantitative range of impact generated by the board for the company. In the final section (2.c.) of the evaluation, this number will be compared to the cost of ("investment in") the board in order to calculate a ROI figure, a multiple of the cost incurred for the board.

The board set for itself three main areas of focus in line with the objectives set out in the Board Charter:

Annual objectives

Objective	Expected Outcome
Definition of a strategy for the medium and long- term portfolio based on: • maintaining and increasing base capital • preserving and increasing the performance of the portfolio. • rebalancing the portfolio by reducing the exposure to countries A and B	Define Portfolio Strategy within 12 months. Begin rebalancing of portfolio.
To drive the search of one or maximum two new significant investment areas to create a new "core" for the Fund Portfolio	Define core and begin locating investments within 12 months.
Creation of structured processes and policies for investment decision-making. Being involved as advisors to the Investment Committee to help in the investments decision process.	Investment Policy reviewed and functioning within 12 months. Asset Allocation Model in place within 12 months and functioning within 12 months.

Metrics and assessment methods were established to quantify the outcomes of the first three objectives. The results are shown in the table below. It presents the objectives pursued, the board contribution that is being valued, with what KPI it was assessed and based on what data. Finally, the calculation of the value attributed to the board is noted for use in the next step (Evaluation conclusions and review of Board Charter).

Board contributions and their value impact

Objective	BoD Contribution	KPI	Base Data for Impact Value	Work Out (Value-Impact)
Maintaining and increasing base capital; b) preserving and increasing the performance of the portfolio; c) rebalancing of the portfolio (assets and geograhies)	Halt all investments in illiquid assets until Investment Policy is defined. Begin divestment of assets clearly below investment policy targets (see next objective)	Difference in absolute returns between halted illiquid investments and cash and liquid investments preserved. Return expected on cash liberated from investments below IP targets	Average return on smaller illiquid investments over the life of the investment. Average return on cash and liquid assets in the last 12 months.	Differential return between the two asset types was 6%. Additional return on cash liberated from one below-target asset divested. Absolute impact calculated €900K
Creation of structured processes and policies for decision-making in investment	Investment Policy and Asset Allocation Model defined in 6 months	Investment Policy and Asset Allocation Model defined Y/N - Probability of achieving target returns is 75% higher if policies are in place.	Average return on cash and liquid assets in the last 12 months	One percentage point of return X 75% was attributed to the board. Absolute impact calculated €2.5M
To drive the search of one or maximum two new significant investment areas to create a new "core" of the Fund Portfolio	From initial analysis for preparation of Investment Policy, Real Estate was revealed as a clear "core" already significant in the portfolio with interesting returns. Real Estate officially designated as "core"	Estimated return on new potential RE investments made accoding to new IP and Asset Allocaton Model	Average return on RE assets for the fund in the past 3 years. Funds allocated for new investments in RE	I25% of the profitability expected from new RE investments in the next 3 years was attributed to board action. Absolute impact calculated was €300K

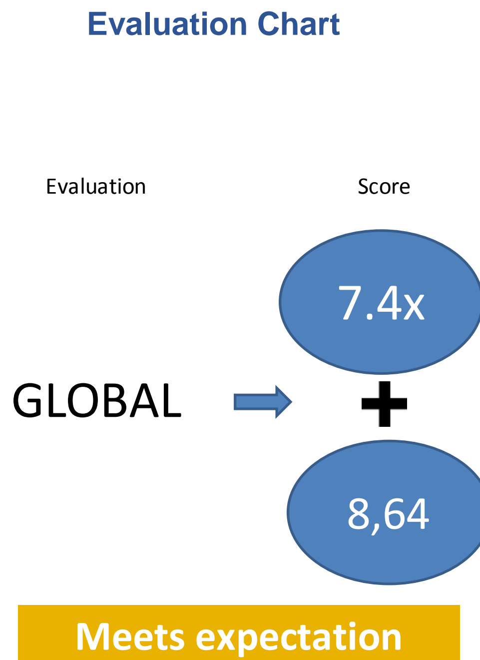
2.c. Evaluation conclusions and review of the Board Charter

The estimated impact of board contributions for the year was **€3,7 M** split as follows:

- Halting new investments (learning to say "no") and beginning divestment of minor assets: €900 K
- Establishing Investment Policy and Asset Allocation Model: € 2.5 M
- Identifying real estate as new core and beginning new deals: €300 K

- Economic cost of Advisory Board: €0, 5 M
- **ROI calculation: 7.4 additional Euros of profit have been obtained for each Euro invested in the Advisory Board (7.4 x)**
- The period considered for impact calculations is 1 year, unless otherwise stated.
- The assessment does not include the impact of those contributions made by the board that have recently been implemented or those whose implementation is still pending.

The following chart combines the qualitative and quantitative aspects of the evaluation:



First Value Fund's board "meets expectations", but is not reaching its full potential yet. The relatively high qualitative score at 8.64 can still improve, if the process aspects related to quality and quantity of information are in turn bettered. Furthermore, the return on the amount invested in the board, although high, is still not satisfactory in the experience of the author (it is below 10). This is explained by the fact that in the first twelve months, the board devoted significant time and effort to the definition and formalization of an investment policy and an asset allocation model. The outcomes of this work, however, make for an optimistic view regarding the following year, since it has already had two very worthwhile effects, noted above, which will continue to provide returns to the company, namely:

- Learning to say "no" and formalizing decision making, as a result of halting all investments while the investment policy and asset allocation model were designed.

- Identifying real estate as a "core" investment area, yielded by the analysis to define the investment policy.

- Establishing processes that generate more transparency and accountability before decisions are made.

Finally, the Board Charter was reviewed. Work remains to be done to consolidate the heavy process work done during 2016, the two objectives set for the year, therefore, continue under observation. However, objectives related to divestment, geographic diversification and the generation of new investment opportunities, particularly in real estate, came to the fore in this revision of the Charter. As a result, a proposal has been placed on the table to add a new board member, with greater expertise than currently available from the board as it stand now. No variations in process were included in the revision, although the need for greater emphasis on the quality of the information was noted.

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In summary, these three real life examples prove beyond doubt the effectiveness and profitability of investing in a high impact board, using the method and system herewith explained in detail.

VII. Conclusions

Corporate governance and boards receiving much attention

Although perhaps somewhat late with respect to other fields of corporate management both the literature and practitioners, such as companies, regulators, directors, etc., are giving it ever increasing importance, starting to recognize the potential *positive impact* that good boards can have on the companies they serve. It is continually evolving, with new trends affecting the field, such as an increasing emphasis on sustainability, on stakeholders as opposed to shareholders only, and stronger activism from institutional investors. Companies try to respond to new demands but they progress slowly.

The various theoretical frameworks put forth regarding boards help to understand reality, but in their endeavor to isolate variables, they tend to have a somewhat narrow focus. This makes their prescriptions relatively impractical to use for boards and directors. Furthermore, the Agency theory perspective is still by far the most influential, which results in the control role of the board –and the compliance function vis-à-vis shareholders– having a degree of importance that is perhaps out of proportion in the reality of most companies.

Yet there is an important and ever-growing chorus of voices, especially from practitioners, but also from the literature and regulators as well, that recognizes and defends the relevant and potentially positive role of the board in designing strategy and driving its implementation.

Furthermore, the over-dominant control and compliance focus neglects a very large number of companies, SMEs, with an enormous impact on the global economy. SMEs can most certainly benefit from having high performing boards, and for them in particular, a compliance focus is burdensome and not necessarily useful. This compliance focus pushes these companies –which in many cases are legally required to have a board– to establish "rubber-stamp" boards. However, giving their boards more relevance and pointing them in a different direction –strategy, providing useful information and connections, etc.– can add much value to SMEs.

The author's experience reinforces this idea. Boards with a strong and well-defined focus on the business have added great value to them, particularly, when a company is moving into areas that go beyond its expertise and experience. This may be a new market, whether horizontal or vertical, a shift in the business paradigm or simply growing pains, such as an organizational or succession challenges. A board that understands what the challenges are, designed with these in mind, and bringing the relevant expertise to the table, is able to demystify challenges. It provides highly useful, practical and relevant ideas to the management team, assisting them to make better decisions and avoid pitfalls.

Furthermore, compliance has never been the primary focus, in fact, many of these boards are not fiduciary in nature. Interestingly, however, a high degree of transparency and accountability is generated by their existence and the importance key stakeholders (including management) attach to them. This suggests the idea that a board which adds significant value and commands the respect of stakeholders might be more successful at achieving a high real degree of control and compliance than one that is imposed.

It seems to be increasingly evident that the number of companies that could benefit from having a high-performing board is very large, as is the breadth of their situations and challenges. It is of the utmost importance that this latter aspect is recognized, since it will be an important driver of a board performance that goes beyond compliance. Understanding *why* the board of a particular company exists will help to define *what* it does, *who* should be on it and *how* it can best operate. Grasping the individuality of a company will help the board to better serve the company and its stakeholders. In doing so, it will also provide a stronger basis for evaluating the board's performance.

Interest in board evaluations is growing too

Recognized as a useful tool, nevertheless, board evaluations have received less attention and the ideas put forth are overly general. Literature, practitioners and consulting firms tackle evaluations, but end up focusing too much –it is obviously easier– on the commonalities that companies share, but not dealing effectively with their specificities,

failing to recognize the importance of the variety of possible situations companies face. As a result of these specificities, the role of the board may vary significantly as well, which is very relevant to how the effectiveness of a particular board is measured. This is not helped by the fact that boards seem to be the subject of attention more frequently when they fail. Additionally, it has no be noted that, due to the continuing prevalence of Agency theory perspectives, much of the focus on board evaluations has been on best practices centered around control and compliance with regulations.

Companies are consequently left with guidelines that help them to have *compliant* boards but not necessarily boards that are *strategically impactful* for the company over time. This may be the reason why relatively few of the companies that are not obligated by law perform board evaluations and why even those that do conduct them recognize that it is often a perfunctory, box-ticking exercise, with little real impact.

Evaluation methods proposed use several different techniques, from the prevailing self-evaluation, to peer evaluation, to those administered by third parties, from observation based evaluations to the dominant survey-based ones, to combinations of the two.

The theoretical approaches we have studied here all suffer from the same flaw: being performed without a strong, objective and significant benchmark. Because objectives for the board are rarely set in advance, evaluators -whoever they may be- are left with evaluating relatively standard and superficial parameters. Some of these may be relevant, such as the team dynamics, or the timeliness, the quantity and quality of information the board receives, but to a large extent these are the *conditions necessary* to perform, not performance *indicators*. It is essential that an evaluation method considers both. Obviously, a board should have in place the processes necessary to *enable* good performance, but the mere existence of these processes does not mean they will be effective for a specific company. It is not infrequent to see a board composed of bright, potentially impactful people, who work well as a team, who receive reasonably good information in reasonably good time, who are disciplined in their attendance, who are well managed and orderly in their discussions, but who spend most of the time on topics that are not the most relevant for the company, therefore having very limited real impact. Few evaluation systems consider setting objectives, and the ones found during the research for this dissertation are only seen in the practical examples, not in theoretical proposals.

As mentioned before, some form of self-evaluation is predominant, with peer-evaluation following in more advanced organizations. The ABA survey confirms this, with 42% of respondents who evaluate their boards doing so by self-evaluation and 24% using peer-evaluation. In some cases, either of these methods may be administered by a third party, lending some additional objectivity to the process or facilitating the anonymity of peer-evaluation, but all of these cases suffer from the problem mentioned in the preceding paragraph. Although third-party administration of the process may reduce the discomfort that a horizontal evaluation process can create in a group and increase objectivity, it does nothing to increase the specifity of the criteria evaluated. Furthermore, all these forms of evaluation tend to limit their scope to the participants in the board and only very rarely extend to other stakeholders who may be relevant. In summary, none of the evaluation processes analyzed have strong specificity and their objectivity is limited to factors that are *enablers* of performance but not *performance indicators,* as noted earlier.

Not even companies considered outstanding in corporate governance practices (Microsoft Corporation, British American Tobacco, Banco Santander in Spain…) seem to fully implement the type of board evaluation that would really advance their companies' strategic goals and create long term value for their stakeholders, although some of them, notably BAT and Banco Santander, are seemingly advancing in that direction.

The new evaluation tool for the 21st century

Based on research of written information sources, the ample survey conducted by the author's firm (ABA) and his direct hands-on experience, the new method proposed here was devised and successfully applied in a variety of companies from different sizes and industries, different stages of development, in different geographies.

The salient features of this new evaluation system are that it is *specific*, *objective* and *systematic*. The literature and practitioners widely recommend that evaluation methods be systematic. They also try to find ways to make them as objective as possible.

The proposed method is *specific*, starting with an exercise in setting objectives for the board, which pertain to how *this* board should perform to provide impact to *this* company. This helps to provide a strong focus for the action of the board and sets an objective benchmark against which performance can subsequently be measured. This specificity covers both the process aspects of the board –the *enablers* of board performance – as well as the expected outcomes –the *indicators*. Thus, the method allows performance to be measured and the detection of possible changes that can help improve that performance. The method not only answers the question "¿did we devote enough time to strategy discussion?" but also "¿did we devote time to the strategic discussions we identified as most important?".

Because it is specific and begins with objective setting, it is also *objective* and can be self-administered, although third-party administration may make it easier. It removes the subjectivity of asking board members to consider if they had a positive impact, allowing them to instead check if they achieved the objectives they set and reflect on why they did or did not.

Finally, the method is *systematic*. Although it is always tailored to take into account the specific circumstances and needs of the company, it ensures that all the necessary elements are evaluated. It also prescribes regular time frames and techniques with which to perform the evaluation of both the enablers and the indicators of performance.

Using this method in practice allowed the boards of the subject companies to focus on what was important very quickly. Because objectives were set in advance, board members began making relevant, actionable proposals from their first meeting. The depth and significance of the contributions then evolved as the group gelled as a team. The post-meeting process evaluations were key to this, as process improvements could be made from one meeting to the next and board members received feedback on their performance immediately. This generates both a *friendly competitiveness* among board members as they get to know their impact individually (and could consider how it stood up to those of their peers), as well as an environment of respect and trust, since they also see first-hand the enhancement that their capacity to engage in respectful collective reasoning provided to the outcomes of their board discussions.

None of the companies that began using this method -the first of them started in 2013- have abandoned it.

In summary, the new evaluation system has proved its worth in the real world. Up to now, to a limited extent. The author continues to seek to improve it, to keep it as simple as possible to use and to continually reinforce its objectivity. It is his belief that it can become a very powerful tool in the future, as its use extends. That is what the author set out to achieve with this dissertation -to spread the good news!

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