# BOARD EVALUATIONS AND BOARDROOM DYNAMICS

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## INTRODUCTION

The New York Stock Exchange requires that the boards of all publicly traded corporations "conduct a self-evaluation at least annually to determine whether it and its committees are functioning effectively."[1] The purpose of this exercise is to ensure that boards are staffed and led appropriately; that board members, individually and collectively, are effective in fulfilling their obligations; and that reliable processes are in place to satisfy basic oversight requirements in areas such as strategy, risk management, financial reporting, performance measurement, compensation, and succession planning.

Research evidence suggests that, while many directors are satisfied with the job that they and their fellow board members do, board evaluations and boardroom performance fall short along several important dimensions. According to a study by The Miles Group and the Rock Center for Corporate Governance at Stanford University, directors rate their board a 4 on a scale of 1 to 5 in terms of effectiveness (with 5 being "extremely effective" and 1 being "not at all effective"). The vast majority (89 percent) believe their board has the skills and experience necessary to oversee their company.[2]

Unfortunately, at the same time, respondents express significant negative sentiments. Board evaluations do not appear to be effective at the individual level. Only half (55 percent) of companies that conduct board evaluations evaluate individual directors, and only one-third (36 percent) believe their company does a very good job of accurately assessing the performance of individual directors (see Exhibit 1). More attention to individual assessment is a necessary step to ensuring the performance of the group in aggregate. Directors also have only modest satisfaction with boardroom dynamics. Only two-thirds (64 percent) of directors strongly believe their board is open to new points of view; only half strongly believe their board leverages the skills of all board members; and less than half (46 percent) strongly believe their board tolerates dissent. Forty-six percent believe that a subset of directors has an outsized influence on board decisions (a dynamic referred to as "a board within a board"). The typical director believes that at least one fellow director should be removed from their board because this individual is not effective.

These are troubling statistics that suggest that many companies do not use board evaluations to optimize the contribution of their members.

## BOARD EVALUATIONS

Board evaluations typically start with a review of board structures and processes, and are often performed by the general counsel or outside legal counsel. It includes a checklist of items that public companies are required to review and the standards associated with them. For example, it reviews whether the company has structured its committees appropriately; whether the company is complying with the governance requirements of Sarbanes Oxley, Dodd Frank, and other state and regulatory statutes; and whether the company is adhering to a set of processes that are commensurate with so-called best practices advocated by governing bodies and certain shareholder groups.

The more difficult but also more value-producing part of the board evaluation process is to review the contribution of individual directors and the interpersonal and group dynamics among board members. As the data above indicates, this exercise is often not performed in a rigorous matter and in many companies is omitted entirely, so that directors can move on to the real job of "being a board member." This attitude is a mistake. Although more difficult and time consuming, the review of individual members and interpersonal dynamics represents the greatest opportunity for improvement by examining the roles, contribution, and effectiveness of each board member.

Key elements include the following:

### *How You Lead*

This section evaluates the effectiveness of board leadership, including the lead independent director (or independent chairman) and committee chairs. It examines how the leader was chosen, the skills and experiences that this individual brings to bear, and his or her leadership style. Not everyone is qualified to lead a board or committee. A director might be a valuable board member (or even an effective current or former CEO) but not qualified for board leadership. The company should develop criteria for these roles and evaluate the available skill sets of its members to determine who is most suitable. Companies should avoid appointing a leader by default (i.e., the person who volunteers to do the job or the most senior member of the board) or solely looking to the required background (such as a qualified financial expert) because temperament is often key to effectiveness in the role. These individuals are the interface with management and need a communication style that is clear, concise, and constructive. A successful board leader needs to be adept at translating the voice of the board to management, and the voice of management to the board. The lead director, for example, should facilitate the board in a way that earns respect from its members. He or she is responsible for encouraging broad participation, cajoling if necessary, and bringing the right people into the conversation at the right time. This requires effort both within and outside the boardroom itself and requires a range of leadership styles to line up effectively with the board's diverse members. Finally, the lead director can also be responsible for managing the evaluation processes and delivering feedback or arranging coaching for directors that require it.

The inadequacy of leadership among many boards is evident from survey results. Only 72 percent of directors believe their leader is effective in inviting the participation of all directors, and only 68 percent believe they are effective in inviting the participation of new members. Only 60 percent believe their lead director "asks the right questions." Worse, only a quarter (26 percent) believe they are very effective in giving direct, personal, and constructive feedback to fellow directors.

*Recommendations*

- Choose board leadership using specific criteria tailored to the role. Not everyone has the behavioral attributes to be effective. Do not promote board members to leadership positions based solely on seniority.
- Be proactive in developing a pipeline of talent available for leadership roles. Create a skills and experience matrix that plots the existing skill sets of directors against the needs of the board.
- Rotate committee chairs to develop a future lead director or chairman and to refresh committees with new perspectives. Do not rotate too frequently such that you create disruption.

### *How You Manage*

This section evaluates the manner in which board meetings are conducted, including whether they are organized for maximum productivity, the honest exchange of ideas, and whether they encourage the full participation of all members. Particular attention should be paid to committee meetings and executive sessions. According to many directors, the "real work" of the board takes place in committees. The evaluation process should determine whether clear expectations are established for the work conducted by committee members and whether committee reports are effective in keeping the full board informed about key issues facing the company. The evaluations should also review executive sessions, which take place outside the presence of management and include only the non-executive (i.e., outside) directors on the board. When structured properly, executive sessions ensure that the day's meetings are productive and serve as an important forum for framing and reviewing discussion topics. Non-executive directors meet at the beginning of the day, before the CEO joins, to discuss key topics and identify areas where directors want to learn more information from management. They then meet again at the end of the day to review and contextualize the information they learned and bring closure to the discussion. When effective, these sessions last no more than 10 to 15 minutes. Long meetings can be a red flag, indicating that board members do not feel comfortable expressing their honest opinions in front of management and instead wait until management is not present to speak freely. This dynamic is detrimental to decision making.

Survey evidence indicates that this can be a problem among many companies. Only two-thirds (68 percent) of board members say they have a very high level of trust in their fellow directors, and only 63 percent believe their board very effectively challenges management. Half (53 percent) believe that their fellow directors do not express their honest opinions in the presence of management.

*Recommendations*

- Set clear expectations for the work expected from committee members. Create opportunities for individual directors to give feedback on committee effectiveness.
- Establish executive sessions at the beginning and end of meetings. Set clear expectations about how directors are to contribute. Be conscious of time.
- Invest in board education. Schedule regular sessions for management or outside advisors to do "deep dives" on specified topics relating to the company, industry, and broad macroeconomic trends.

- Foster trust among board members through retreats, an extra day added to a board meeting, holding board meetings in locations that are conducive to spending some "down time" together, and inviting spouses or partners to join in social opportunities.

### *How You Contribute*

Finally, board evaluations stand to improve by rigorously reviewing the manner in which board members interact, including which directors participate and how decisions are made. Leadership, coaching, and feedback are critical in this regard. Directors have important functional knowledge but are generally not instructed on how best to contribute this knowledge in a boardroom setting. Many come from executive, managerial, or professional backgrounds where they hold positions of leadership. They are brought onto the board to contribute this expertise, but not in a manner that stifles debate and shuts down discussion. They are not recruited to boards to provide the "last word" on topics, with other directors deferring to their opinion. They are recruited to contribute knowledge that the group as a whole can use to make better decisions. In truth, there is no reason to believe that forming a board from a group of successful CEOs will produce a high-functioning board.

Research evidence demonstrates that many boards suffer from poor group dynamics. Three-quarters of directors believe their fellow directors allow personal or past experience to dominate their perspective. A significant minority (44 percent) say that their fellow directors do not understand the boundary between oversight and actively trying to manage the company. Thirty-nine percent report that their fellow board members derail the conversation by introducing issues that are off topic.

These data demonstrate that many directors can improve how they contribute by adopting behaviors such as interacting well with others, asking the right questions, not being directive, leading conversations rather than acting as "the expert," staying engaged, and building on the points of view of others. In particular, individual members can improve how they contribute to the group by managing how they enter the conversation—using questions, setting the context when making comments, and allowing others to participate. Framing content in a constructive fashion earns the attention of both directors and management and demonstrates that the participant is trying to contribute rather than "win" an argument.

### *Recommendations*

- People do not join boards knowing how to be an effective director. It is important to learn how to become an effective director. Give objective feedback to individual directors through the evaluation process.
- Encourage directors to develop range to their style so that they know how to effectively enter a discussion. Encourage discipline in how directors contribute to board discussions. Stay on topic. Build on points. Do not repeat or rephrase what others have already said. Do not refer excessively to personal experience. Avoid derailing the conversation.
- Board leadership should play a key role in keeping discussions to the topic, drawing others in who have not contributed, and ensuring that disparate perspectives are vetted.

## WHY THIS MATTERS

1. All publicly traded companies are required to conduct an annual evaluation of their board of directors to ensure that it is fulfilling its obligations to the company. Research evidence suggests, however, that many board evaluations are a perfunctory exercise that fail to address the performance of individual directors and boardroom dynamics. Why? Are these elements too difficult and time-consuming to evaluate, or do board members not want the feedback? What are the social and psychological barriers to conducting a board evaluation? How can these barriers be reduced?
2. The board of directors is thought of as a high-powered group of individuals brought together for their expertise. The assumption is that once they are assembled around the board table, they will figure out how best to maximize the value of their contribution. Is this assumption valid? What behaviors are required to be successful in a boardroom setting? How different are the roles of professional and board member? What changes are required to be successful in a board environment?
3. The survey data in this Closer Look suggests that many directors are critical of their fellow board members and the manner in which board interactions take place. Among governance experts, however, little attention is paid to the culture of the boardroom. How important is board culture? What role does culture play in influencing the interaction between board members? How does this influence their ability to make decisions? What actions can board leadership take to shape culture and improve performance? ■

[1] New York Stock Exchange, NYSE Listed Company Manual §303A.00, "Corporate Governance Standards."

[2] The research cited in this Closer Look is derived from The Miles Group and the Rock Center for Corporate Governance at Stanford University, "2016 Board of Directors Evaluation and Effectiveness," (2016). Sample includes 187 directors of public and private companies in North America.

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*The Stanford Closer Look Series is a collection of short case studies that explore topics, issues, and controversies in corporate governance and leadership. The Closer Look Series is published by the Corporate Governance Research Initiative at the Stanford Graduate School of Business and the Rock Center for Corporate Governance at Stanford University. For more information, visit: http:/www.gsb.stanford.edu/cgri-research.*

**EXHIBIT 1 — SURVEY DATA ON BOARD EVALUATION AND BOARDROOM DYNAMICS**

HOW WOULD YOU RATE YOUR BOARDS ALONG THE FOLLOWING DIMENSIONS? (SORTED LEAST TO MOST FAVORABLE)

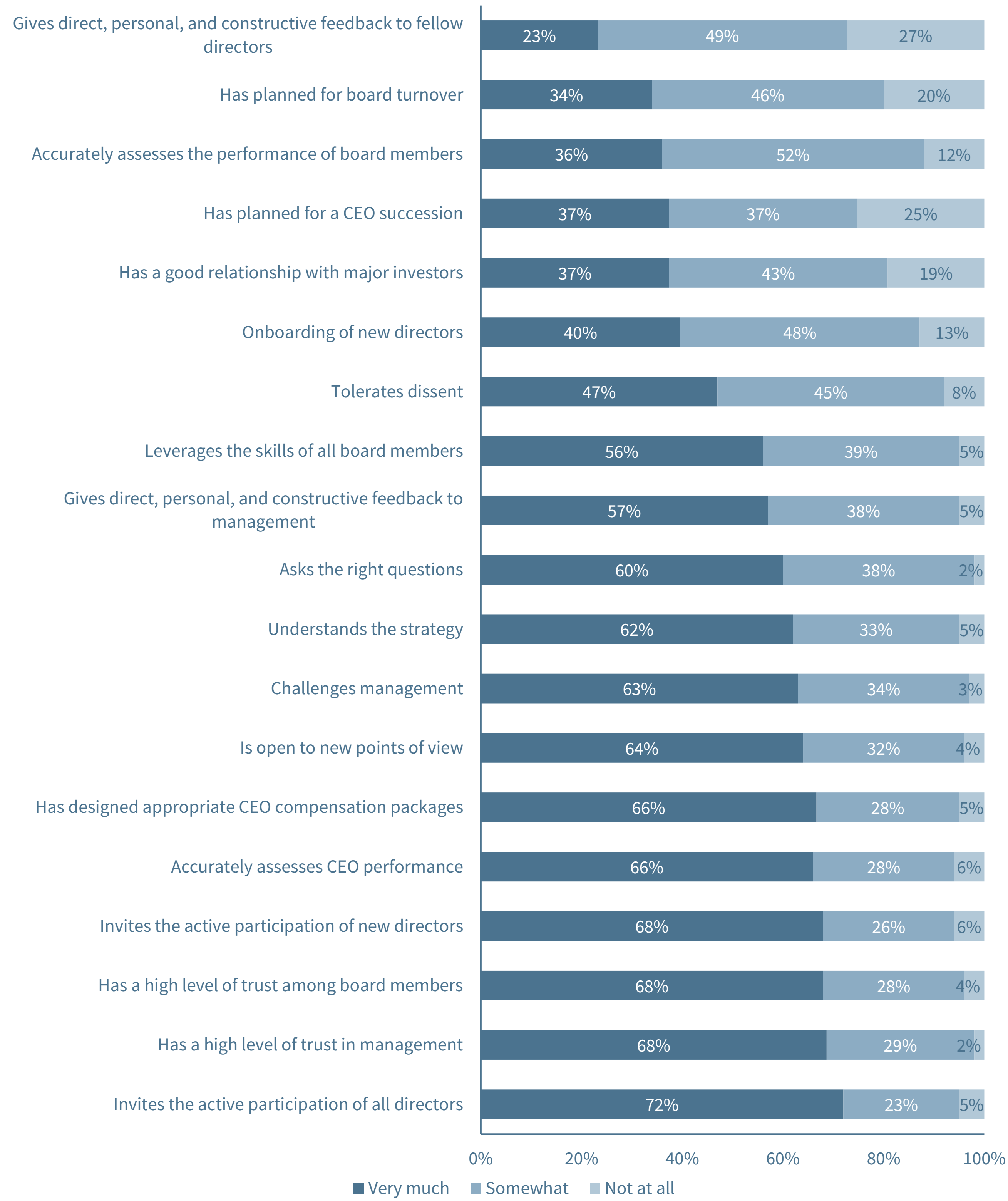


**EXHIBIT 1 — CONTINUED**

TO WHAT EXTENT DO YOU BELIEVE THE FOLLOWING ARE A PROBLEM ON YOUR BOARD?
(SORTED LEAST TO MOST FAVORABLE)

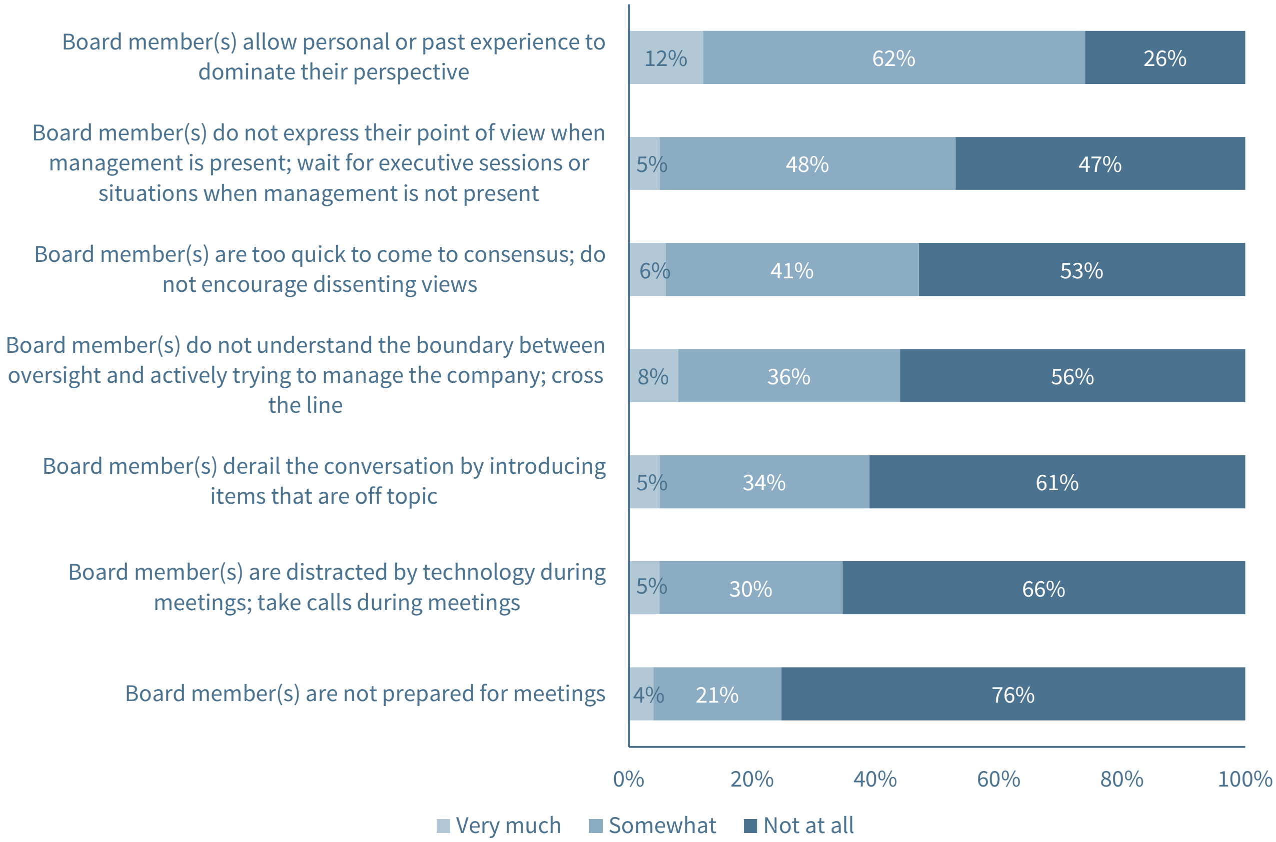
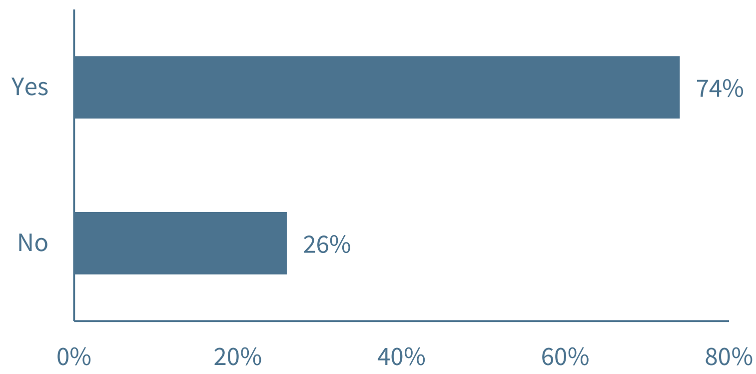
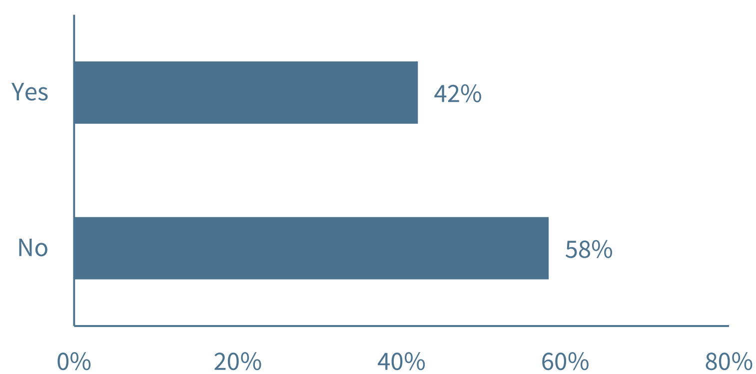


**EXHIBIT 1 — CONTINUED**

DOES YOUR BOARD REGULARLY EVALUATE THE SKILLS AND CAPABILITIES OF DIRECTORS TO ENSURE THAT COMMITTEES ARE CHAIRED AND STAFFED EFFECTIVELY?




DOES YOUR BOARD REGULARLY ROTATE DIRECTORS TO REFRESH COMMITTEES?




DOES YOUR BOARD HAVE A FORMAL SUCCESSION PROCESS FOR COMMITTEE CHAIRS?

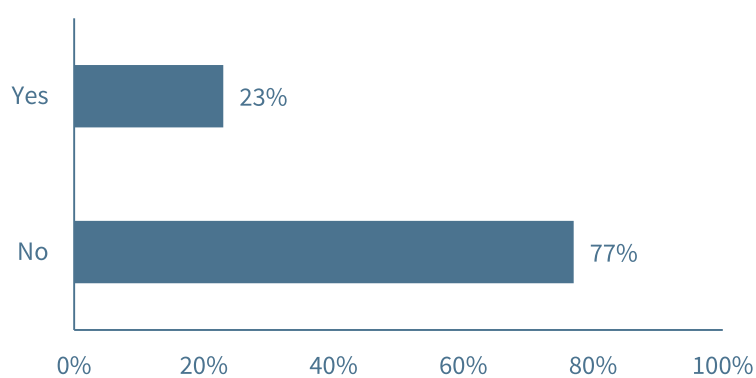
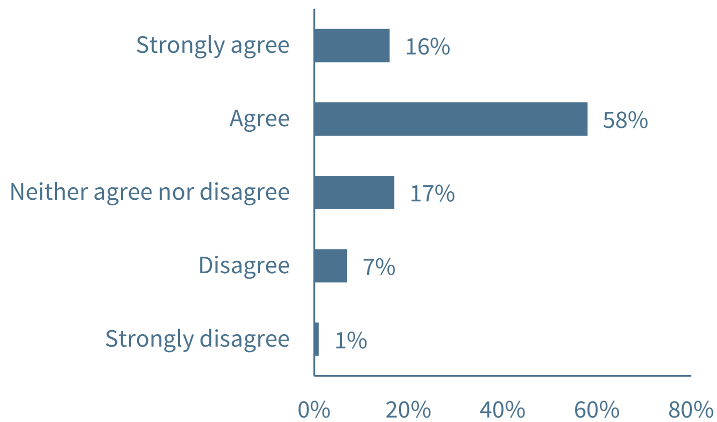
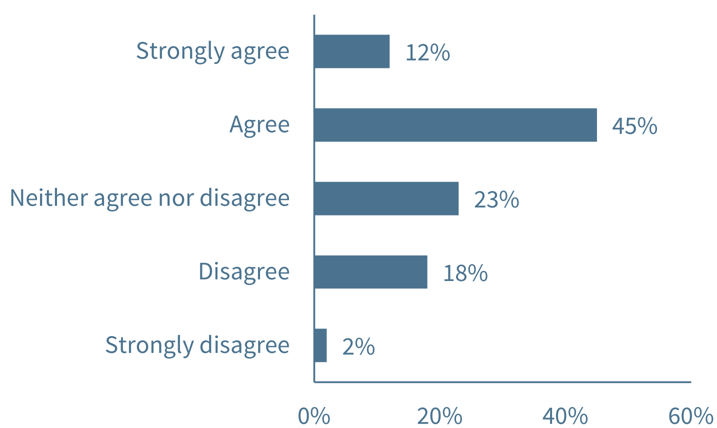


**EXHIBIT 1 — CONTINUED**

TO WHAT EXTENT DO YOU AGREE WITH THE FOLLOWING STATEMENT: "OUR BOARD HAS THE BEST COMPOSITION OF SKILLS AND EXPERIENCES TO MEET THE NEEDS OF THE COMPANY"?




TO WHAT EXTENT DO YOU AGREE WITH THE FOLLOWING STATEMENT: "OUR BOARD IS VERY EFFECTIVE IN BRINGING IN NEW TALENT TO REFRESH THE BOARD'S CAPABILITIES BEFORE THEY BECOME OUTDATED"?




TO WHAT EXTENT DO YOU AGREE WITH THE FOLLOWING STATEMENT: "OUR BOARD IS VERY EFFECTIVE IN DEALING WITH DIRECTORS WHO ARE UNDERPERFORMING OR EXHIBIT POOR BEHAVIOR"?

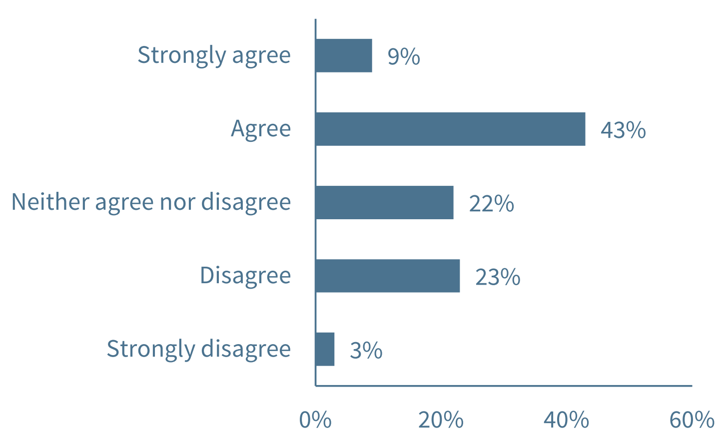
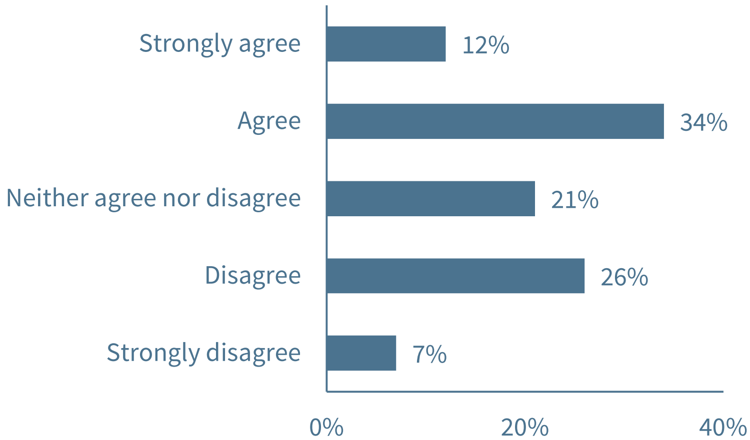
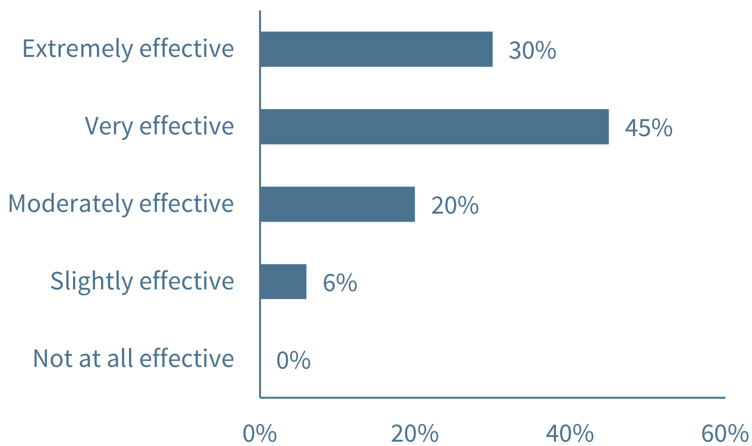


**EXHIBIT 1 — CONTINUED**

TO WHAT EXTENT DO YOU AGREE WITH THE FOLLOWING STATEMENT: “A SUBSET OF DIRECTORS ON OUR BOARD HAS AN OUTSIZED INFLUENCE ON BOARD DECISIONS”?




OVERALL, HOW WOULD YOU RATE THE EFFECTIVENESS OF YOUR BOARD?




Source: The Miles Group and the Rock Center for Corporate Governance at Stanford University, “2016 Board of Directors Evaluation and Effectiveness,” (2016).

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