Evaluating the Board of Directors: International Practice

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Board evaluation can provide a vital tool for directors to review and improve their performance. This will eventually lead to significant value creation opportunities for firms. But is increased regulation and regulatory guidance requiring board evaluation a realistic or sensible move? Is it necessary for regulators to compel boards to be more active in the area of self-evaluation? As is often the case, the risk of regulatory initiatives aimed at forcing or even “nudging” greater responsibility is that it merely encourages “box-ticking” behavior in which managing the appearance of compliance becomes the overriding objective. Resources devoted to managing an image of compliance (and not substantive compliance) are wasted, and the potential gains from meaningful self-evaluation are never realized. However, empirical research presented in this paper seems to indicate that companies that are listed in countries with more specific principles and substantive guidance do tend to adopt more meaningful and open forms of board evaluation practice than their counterparts in jurisdictions with no or less detailed requirements. This does suggest that “law matters” in this context.

Keywords: Board of Directors, Board Diversity, Board Dynamics, Board Evaluation, Corporate Culture, Corporate Governance, Corporate Strategy, Financial Crisis, Independent Directors, Innovation, Value Creation

JEL Classifications: D20, G34, K22, L21, L25, O16

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1. Corporate Governance Today

There is a broad consensus that we need “good” corporate governance. And yet, currently, there is little agreement as to what this actually means or how we might achieve it. Such difficulties are hardly surprising. Contemporary corporate governance frameworks were significantly re-worked in the 2000s in response to a series of high-profile scandals, most notoriously *Enron*. These reforms appear to have had little effect on the performance of listed companies during the 2008 financial crisis. Moreover, the number, scale, and damage of corporate scandals and economic failures do not appear to be diminishing.

One possible reason for this dissatisfaction is that corporate governance has been overly focused on the regulatory design of “checks-and-balances” in listed companies, rather than on the equally important question of how governance structures can add strategic value to a firm. This paper explores this latter issue, with particular reference to the role of board evaluation.

In the conventional “checks and balances” model of corporate governance, authority and empowerment flow “downwards” from the shareholders (the legal and moral owners of a company) through the board of directors/supervisory board to the management and, eventually, employees. Corporate governance mechanisms, which initially targeted executives, were intended to curtail agency problems, notably those that arise between (potentially) self-interested management and investor-owners.

Since management is responsible to the board of directors or supervisory board that, in turn, owes a responsibility to the shareholders or owners of the firm, board members have also been heavily affected by the regulations that have emerged over the last decade. Policymakers emphasized that the monitoring and oversight role of “independent” or “outside” directors are crucial in maximizing shareholder wealth and preventing self-interested transactions. In countries with controlling shareholders, which is common in Europe and Asia, board members are also expected to protect the interests of “minority investors” and other stakeholders in the company. This is necessary because controlling block shareholders may engage in self-interested transactions that are detrimental to the interests of minority shareholders or other stakeholders.

Following the 2008 Financial Crisis, a predominantly independent board was considered essential to serve as a necessary and dynamic “wedge” between the company and its insiders, on the one hand, and the capital market and the short-term investors, on the other. Such an arrangement reduced the three-way agency problems between the executive managers and the varying types of investors and stakeholders. There was a widespread view that the board of directors should be insulated from shareholder influence and interventions. Board independence was, therefore, deemed necessary to resist the short-term mentality that prevailed (and often still prevails) in the investor community and capital markets.

Still, despite this greater emphasis on a longer-term approach to company governance, the dominant view has been to treat the board as supervisor/monitors of the senior managers. In consequence, the board of directors tends to focus on the *control* of management behavior and the monitoring of company past-performance and sustainability.

An alternative way of framing the issue, however, would be to move beyond a control framework and recognize that a well-balanced board can be a competitive advantage for a company regarding innovation and value creation. The *G20/OECD Principles of Corporate Governance*, for instance, confirm this view: "Together with guiding corporate strategy, the board is chiefly responsible for monitoring managerial performance and achieving an adequate return for shareholders, while preventing conflicts of interest and balancing competing demands on the corporation." It is interesting to see that this view receives greater attention recently. Consider *The New Paradigm, A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth*, issued on 2 September 2016 by the International Council of the World Economic Forum.

Moreover, many companies, as well as their investors, now recognize that the "monitoring" role is no longer sufficient and that the model of board supervisions and independence constitutes a missed opportunity. Instead, more innovative firms have integrated a diverse range of individuals on the board and they are expected to work in collaboration with the firm's CEO and other senior managers in developing new business strategies. These directors help the firm stay relevant via the inclusion of diverse perspectives that are directly relevant to that company and its operations. A more collaborative model of the relationship between the board and senior management (and the companies' investors) ensures that these different perspectives are incorporated into the decision-making processes in a way that can add genuine value to a firm's business operations.

It is in this context that policymakers and regulators seek to understand better the factors that impact the effectiveness of boards. So far, however, the discussion has focused on many legal formalities and requirements, including gender balance, optimal board size, remuneration, and the role of the chair of the board.

Recently, board evaluation and evaluation processes have been added to this list. In particular, many boards have recognized that it would be vital for them to evaluate and assess the effectiveness of their performance frequently. This has resulted in more attention to board evaluations in both rules-based, as well as principles-based, jurisdictions. For instance, the *G20/OECD Corporate Governance Principles* recommend including regular board evaluations in a country's corporate governance framework. The *New Paradigm* also tasks the board of directors with evaluating its own performance, as well as assessing the performance of its directors and board committees. This paper, therefore, attempts to answer some critical questions regarding board evaluations including:

- What is the role of the board of directors?
- What is the most effective mix of director skills?
- What are their responsibilities in terms of good governance?

- What are the key topics to be addressed in the board evaluation process?
- How frequently should a board be evaluated?
- Should the evaluation be conducted by an external consultant or by an insider?
- What are the current international practices for board evaluations?
- Should board evaluations be disclosed?
- What is the role of regulators in promoting board evaluations?

2. Issues to be Addressed in the Evaluation Process

It has become a familiar refrain, particularly post-*Enron* and post-financial crisis that, to be truly effective, a board needs to increase its role in the area of risk management and managerial oversight. This is also acknowledged in the *G20/OECD Principles of Corporate Governance*. But more is still needed. Most legal systems around the world now recognize that boards not only have a vital role to play in the area of monitoring and risk oversight but also in giving informal advice and strategic support to senior management.

This view is confirmed by an analysis of the boards of directors of the *Forbes* 2014, 2015 and 2016 lists of the "100 Most Innovative Companies in the World". Such an analysis indicates that boards can and should play a much more significant strategic role in the creation of new products or processes.

A well-functioning board provides companies with a clear competitive advantage. Such a board can help build connections with government, society and other stakeholders. They assist company leaders in making better decisions and avoid tunnel vision by providing them with relevant information on the current state of the business environment in which they operate. Boards can also facilitate the identification of new business opportunities or provide a better sense of their peers and competitors. Finally, pro-active board members with relevant expertise can help business leaders in identifying "expertise gaps" on their executive teams. It is in this collaborative context where boards can have the most impact on a company's business strategies and capacity for innovation.

The dynamics and functioning of the board are critical in this regard. For a company to grow, thrive and reach its full potential, corporate boards are expected to be committed, alert and inquisitive. More importantly, they should be pro-actively engaged in the company's business and affairs. Only board members who prepare for meetings and frequently attend them can add value to the discussions. But board members also need to ask hard questions and challenge the strategic assumptions of management. And they can only do this effectively when they possess the relevant capacities and a willingness to devote energy to the tasks of both monitoring and strategy building.

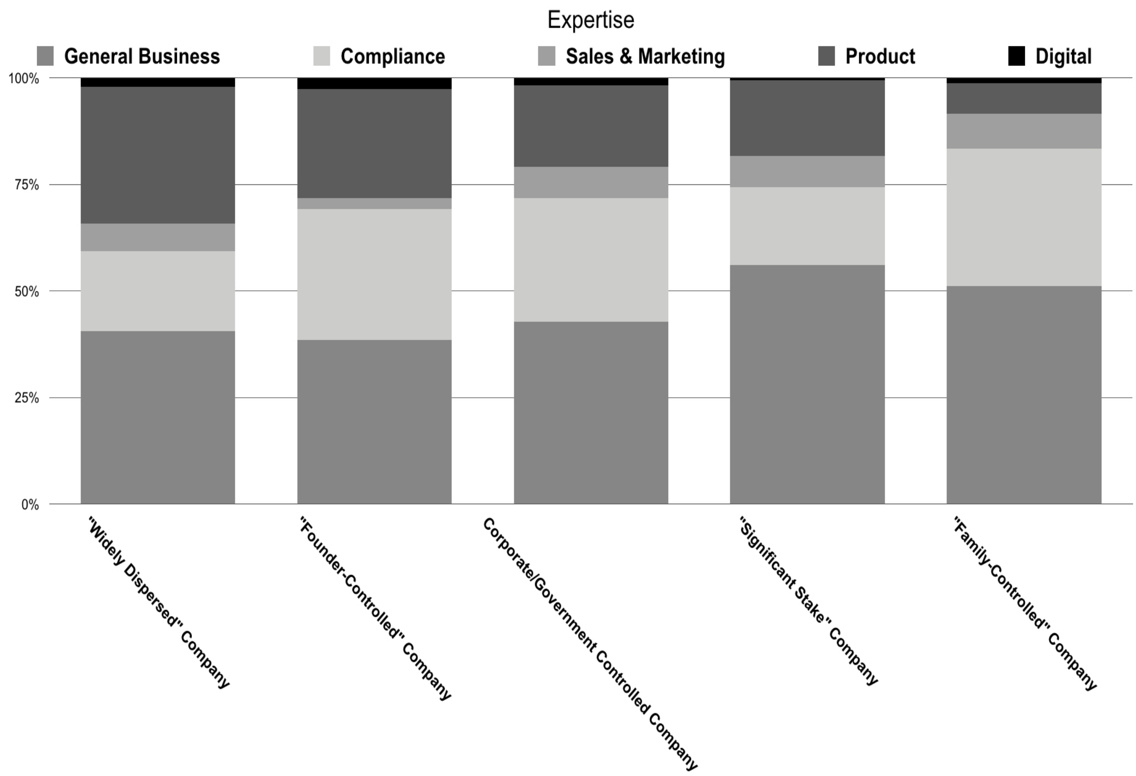
However, board members often complain that there is not enough time to discuss future strategy developments, innovation, and value creation. It is an often-heard complaint at conferences that board members of listed companies have to spend 80% of the time at board meetings on discussing issues related to past-performance and regulatory compliance. In such a context, the ability of board members to add genuine strategic value is severely limited. In some countries, such as France, it is becoming common practice for companies to organize an annual one-day strategy seminar. This provides an opportunity for the board to engage with top management regarding the implementation of the strategy.

An important reason for this current over-emphasis on oversight, supervision and risk management (and the subsequent lack of time for boards to adequately perform the advisory function), is the monitoring-oriented board composition. If the balance of a board is tilted towards those with a general business and finance expertise, then it is hardly surprising that the agenda (and time) of the board is devoted to backward-looking issues.

This is not to understate or dismiss the monitoring function. Obviously, in a contemporary regulatory context, it is vital that a board devotes energy to monitoring compliance. However, it is equally important to stress the value of board diversity and, in particular, the importance of board members that can help develop new business strategies in partnership with senior executives. After all, such procedures are crucial to the long-term success - possibly even the survival - of any firm.

The analysis of the board compositions of "the most innovative companies in the world" (at least, according to Forbes) highlights the importance of board diversity. *Figure 1* below presents evidence of board diversity regarding different types of expertise.

Figure 1. Who are the Independent Directors in the World's Most Innovative Companies?



Source: Authors' research

Most companies in the *Forbes* sample now have boards that consist of independent members, not only with general management and global business experience and expertise (which is usually met by the presence of other CEOs, former CEOs, and business leaders), but also a "compliance-orientation", such as accountants, auditors and lawyers.

What is more important, however, is that the boards also have selected a number of individuals with substantive and relevant knowledge of products, product cycles, and innovation. What is remarkable is that the technical experts outnumber the members that are experienced and skilled in "sales and marketing."

Who then are these "innovation experts"? Some of them can be viewed as technologists or technical visionaries. Often such individuals have been responsible for product innovation or product development at companies that operate in similar markets or the periphery of a company's core business. Others may hold academic positions, particularly in the area of biotech, medicine, and engineering. This is consistent with the intuition that their presence can be invaluable in identifying issues and opportunities regarding disruptive innovation.

More importantly, such experts can add vision and drive to the board of directors. The evidence indicates that most companies realize that they operate in uncertain, fast-moving and highly competitive global markets. What is interesting in this respect is that the top-50 companies on the Forbes list have on average two "product-oriented" independent board members compared to one product-oriented board member in the bottom-50 companies.

Finally, another noteworthy feature of this data is that the composition of the board of directors is "fluid" and dynamic. This is also reflected in *Figure 1*, which confirms that the composition of the board of directors is dependent on the ownership structure of the company. A more than average number of board members with specific product-cycle expertise can be found in companies that are characterized by a widely dispersed ownership structure.

In "controlled" companies, managements' decisions regarding product innovation and development are usually challenged by the significant or controlling shareholders. This is different in a founder-ownership structure. The most important reason for this is that such companies often operate in more volatile or unpredictable sectors, such as pharmaceuticals, biotechnology, and software.

Another observation in this regard is the digital technology experts that were appointed to the boards of directors of companies in our sample. Since their ability to add value in a digital age is beyond question, many more companies can be expected to appoint "digital technology people" to the board of directors. This is a necessary step to deal with the digital challenges and opportunities in today's business environment. In this respect, all firms need to become "technology" and "platform" firms to succeed in today's global and networked markets.

An example of a board with such digital and social media experience is The *Walt Disney Company*. Sheryl Sandberg (*Facebook*) and Jack Dorsey (*Twitter* and *Square*) were added to the Board of Directors to bring the necessary technology and platform expertise to the board. Such knowledge was seen as:

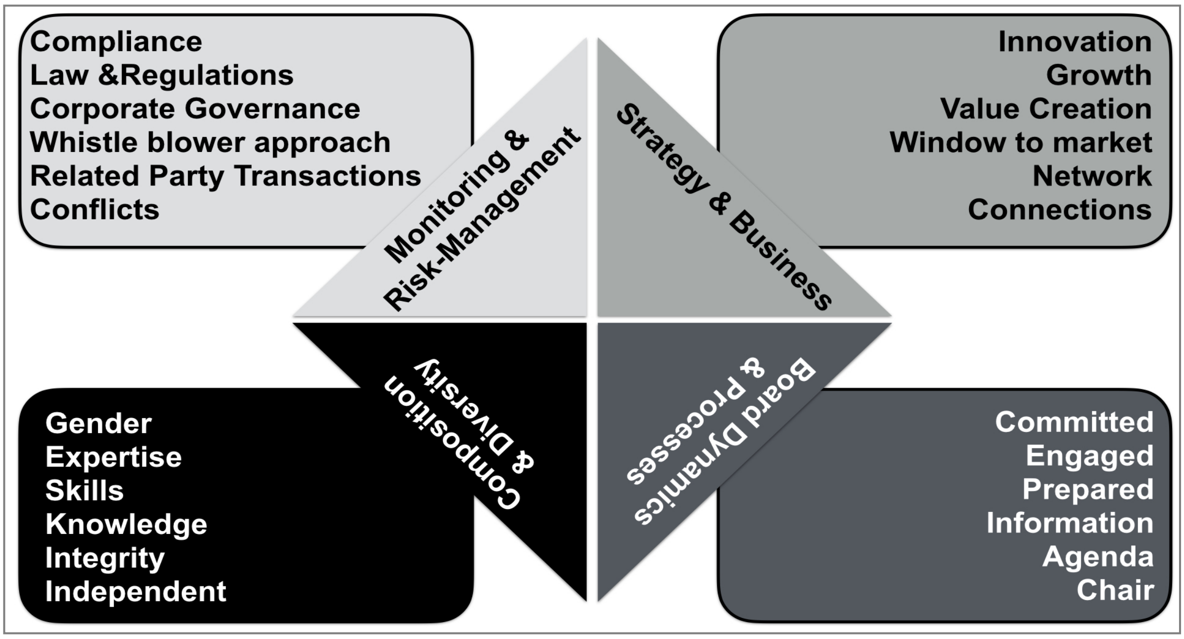
Extremely valuable, given *Disney*'s strategic priorities, which include utilizing the latest technologies and platforms to reach more people and to enhance the relationship we have with *Disney*'s customers. Indeed, *Disney* seems to understand that the directors help the firm stay relevant by the inclusion of diverse perspectives that are relevant to the company. Moreover, this facilitates a more collaborative model of the relationship with management and ensures that a platform perspective is incorporated into the decision-making processes in a way that adds genuine value.

It follows from the above discussion of board diversity that the performance and effectiveness of the board can be measured along "four dimensions" (see *Figure 2*):

1. The quality of the monitoring and risk-management role.
2. The quality of the strategic and other business-related advice.
3. The board dynamics and board members' pro-active participation.
4. The board composition and diversity

A tool to examine how the board operates along these four dimensions is the key to board evaluation today. Since this type of evaluation also helps improve the effectiveness of a board, it should come as little surprise that countries are increasingly implementing rules and regulations regarding such evaluations. The next section provides an overview of current international practice regarding board evaluation.

Figure 2. The "Four Dimensions" of Board Evaluation



Source: Authors' research

3. International Practices for Board Evaluations

As a first step in seeking to better understand board evaluation, it is important to understand how various jurisdictions have actually implemented these processes. This paper analyzed board evaluation practices in the following countries:

- Austria
- Brazil
- People's Republic of China (hereafter "China")
- France
- Germany
- Hungary
- India
- Israel
- Italy
- Japan
- Luxembourg
- Netherlands
- Poland
- Singapore
- South Africa
- Spain
- Switzerland
- Turkey
- United Kingdom
- United States

In this section, we first briefly describe the methodology adopted in this study (*Section 3.1*) and identify the various different approaches to board evaluations (*Section 3.2*). The key takeaway is that board evaluations are slowly becoming the norm in the majority of researched countries. Yet, the analysis also shows that there are significant differences in the evaluation approaches adopted among the different countries.

3.1. A Note on Methodology

The questions addressed were:

- Are there any legal or regulatory requirements or practices that require a board (or its committees) to engage in board evaluation processes?
- How frequently do such evaluations take place?
- Who conducts these evaluations?
- What do companies disclose regarding the evaluation process?

To explore these issues, a review of current legal practice was conducted, focusing in particular on rules and regulations regarding board evaluations. The information regarding these evaluations was collected from a range of sources, such as (1) Online available laws, regulations and corporate governance codes; (2) Regulators' websites and other publicly available materials; (3) Consultancy reports; (4) Questionnaire reports published by "*Getting the Deal Through*" in July 2016; (5) Publicly available research papers; and, (6) Information requested from local law firms/universities. The information contained in this paper is accurate as of late 2017, although we would contend that the framework and conclusions are valid even in the event of regulatory reforms.

A number of considerations influenced the choice of jurisdictions. Most obviously, jurisdictions from different continents were selected. Moreover, the sample contains countries with diverse legal origins and ownership structures. Broadly speaking, the 20 selected jurisdictions (see *Figure 3*) can be split into three legal traditions, namely English common law (India, Israel, Singapore, South Africa, the United Kingdom, and the United States), French civil law (Brazil, France, Italy, Luxembourg, The Netherlands, and Spain), and German civil law (China, Germany, Hungary, Japan, Poland, Serbia, Switzerland, and Turkey).

Figure 3. Researched Jurisdictions

In this context, a distinction between legal origins makes sense because of the different legal approaches to company oversight and the organization and structure of the board of directors. In the common law systems, for instance, we find the Anglo-American one-tier board system. A one-tier board consists of both executive and non-executive, usually independent directors.

Although certain powers are usually delegated to board committees, such as a nominating committee, an audit committee and a compensation committee, the board as a whole is responsible for the decisions it makes based on the input of the committees. In theory, one-tier boards (in which independent directors interact directly with executive managers, particularly the Chief Executive Officer) are well equipped to contribute to and support the planning and implementation of a company's strategy, without ignoring its oversight responsibilities.

Two-tier systems are common in German civil law countries in Asia, Europe and South America. In two-tier systems, the oversight of management is the responsibility of a separate supervisory board. Here it should be noted that civil law systems increasingly facilitate the establishment of one-tier boards. For example, although French law allows companies to choose between a two and one-tier system, French companies are increasingly deciding to have a one-tier board. In Europe, this trend is largely inspired by the Statute for the European Company, explicitly allowing companies to select a one-tier structure. In Japan, an amendment to the Commercial Code ostensibly introduced an Anglo-America style board structure in 2003.

There are also significant differences in the prevailing ownership structures. The widely dispersed stockholders can be found in the United Kingdom and the United States**.** The concentrated ownership characteristics are present in most of the other countries in the sample. Moreover, countries can also be characterized by the type of controlling shareholder (in China, for example, state-owned enterprises play a pivotal role, whereas Turkey is mainly dominated by family-owned companies).

To map how board evaluation work in the different jurisdictions, we categorize them as follows:

- Countries that have not introduced any specific rules or regulations on board evaluations.
- Countries that have no specific rules and regulations but have witnessed the emergence of board evaluation practices.
- Countries that have implicit "board evaluation" rules and/or principles.
- Countries that have introduced board evaluation principles in their corporate governance codes.
- Countries that have introduced board evaluation rules and regulations.

3.2. Five Different Regulatory Approaches to Board Evaluation

3.2.1. Countries Without Board Evaluation Regulations

Only one of the twenty researched countries, China has not introduced or implemented any specific rules, regulations or best-practices on board evaluations. Also, we have not found any indication that board evaluation processes have become a widespread practice in China.

That is not to say that the boards in China are not subject to any evaluation process. An implicit assessment of the functioning and operation of the supervisory board lies in the members' commitment to abnegate short-term self-interest and to promote the welfare of the company rather than their own.

Several standards of performance can be distinguished here: (1) a duty of care, (2) a duty of loyalty to preclude from self-dealing transactions, personal use of corporate assets, usurpation of corporate opportunities, and (3) a duty of good faith and fair dealing. Members of a supervisory board who do not act with the care that a person in a similar position would reasonably exercise under similar circumstances, run the risk of not being granted discharge from any liabilities that may arise from their "misbehavior". The decision to discharge the supervisory board and its members is part of the annual meeting of shareholders.

It is worth noting that despite the non-existence of explicit board evaluation rules and principles, board evaluation processes do occur within listed companies in this "two-tier board" country. Companies can introduce board evaluation provisions in their articles of association or bylaws.

More importantly, it appears that the larger companies start including very general "board evaluation" information in their annual reports. For instance, the largest listed companies in China include statements about (1) how the independent directors have performed their duties, in particular, whether they have objected to any proposals at the board meetings; and (2) how each of the board committees has performed their duties, in terms of how often they had meetings and which items were discussed and approved in these meetings.

3.2.2. Countries with Emerging Board Evaluation Practices

The recognition that boards must become more engaged, knowledgeable and effective both in one-tier and two-tier countries explains why we see more board evaluation practices in countries without any explicit requirements to do so. Israel appears to be an example of this. So far, only financial institutions, such as banks, are required to evaluate their boards of directors every two years. They have full discretion on how to conduct the evaluation. There are no disclosure requirements.

It is not surprising that board evaluations are gaining attention in countries without any specific legal requirements. In Israel, for instance, consultancy and advisory firms seem to encourage companies to put the issue of board effectiveness on the corporate governance agenda. This trend will only become more apparent when these consultancy firms start publishing research reports on board evaluations. Here it should also be noted that Israel has a relatively large number of dual-listed companies.

3.2.3. Countries with Implicit Board Evaluation Requirements

In Poland and Turkey, there are no specific laws or regulations setting out the process or procedures for board evaluations. Of course, as in the other researched countries, the general duties of care and loyalty apply to the supervisory board and its members. In this regard, it could be argued that a continuous evaluation of the performance of the board and its members is part and parcel of the board's duties. What is interesting is that supervisory boards of listed companies in Turkey must (or are recommended) to prepare a written statement for the general meeting of shareholders, including information about their oversight and monitoring activities as well as the number of supervisory board meetings and attendance sheets.

A similar reference to the self-assessment of the supervisory board can be found in Poland. Even though it was expected that this type of requirement would spur a more in-depth evaluation of the board's performance, there is no evidence that Polish and Turkish boards have generally started to submit themselves to the discipline of frequent board evaluation processes.

3.2.4. Countries with Board Evaluation Principles in their Corporate Governance Codes

It is expected that countries that explicitly introduce board evaluation provisions in the company laws, securities regulations or corporate governance codes are much better in increasing the number of boards that engage in formal board evaluation processes.

Take Japan as an example. As a result of, among other things, adopting a corporate governance code in 2015, Japan has risen in the Asian Corporate Governance Association rankings. What is probably more important is that these initiatives spurred a much greater interest in Japanese firms amongst international, and especially US, investors.

Japan's corporate governance code also contains principles regarding the evaluation of board effectiveness:

> Each year the board should analyze and evaluate its effectiveness as a whole, taking into consideration the relevant matters, including the self-evaluations of each director. A summary of the results should be disclosed.

As for the impact of these provisions, it is difficult to reach firm conclusions. Yet, an empirical analysis of the impact of corporate governance code provisions seems to indicate that board assessments in countries with general provisions are falling short of their promise of genuinely enhancing board effectiveness.

Consider the experience of board evaluations in Switzerland. The 2014 corporate governance code states that: "The Board of Directors should self-evaluate its own performance and that of its committees annually." However, the impact of the code appears to be disappointing. Data published by Spencer Stuart in 2015 shows that just 5% of the major Swiss companies conducted an external board evaluation. In 2016, it was reported that a legal practice for board assessments and evaluations was still to emerge in Switzerland.

What is interesting is that the corporate governance codes of other countries that fall within the German civil law tradition (and have a very strong two-tier governance tradition), such as Germany, Austria and Hungary, only very generally describe the board evaluation and effectiveness requirements.

For example, the German corporate governance code states that: “The Supervisory Board shall examine the efficiency of its activities on a regular basis.” The evaluation of individual members is not prescribed. It is therefore not surprising that the assessment of members of supervisory boards is not common practice in Germany. The board evaluation provision in the corporate governance code of Austria is slightly more detailed, specifying the frequency of the evaluation: “The supervisory board shall discuss the efficiency of its activities annually, in particular, its organization and work procedures (self-evaluation).”

To be sure, 2015 Spencer Stuart data shows that 23.3% of the DAX30 companies in Germany submitted themselves to an external assessment (even though the involvement of external parties is not explicitly recommended). This could be viewed as successful, but is still considerably lower than the percentage in other European countries with more detailed “board evaluation” provisions in their corporate governance codes, such as The Netherlands (28%), France (30%), Italy (35%) and the United Kingdom (43.3%).

Since listed companies tend to take a compliance-oriented approach when it comes to corporate governance, the impact of more detailed board evaluation principles is arguably more effective. The board evaluation principles in the United Kingdom are a good example of more detailed assessment requirements:

> *Main Principle*
> The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.
>
> *Supporting Principles*
> Evaluation of the board should consider the balance of skills, experience, independence and knowledge of the company on the board, its diversity, including gender, how the board works together as a unit, and other factors relevant to its effectiveness.
> The chairman should act on the results of the performance evaluation by recognizing the strengths and addressing the weaknesses of the board and, where appropriate, proposing new members be appointed to the board or seeking the resignation of directors.
> Individual evaluation should aim to show whether each director continues to contribute effectively and to demonstrate commitment to the role (including commitment of time for board and committee meetings and any other duties).

> *Code Provisions*
> B.6.1. The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted.
> B.6.2. Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years. The external facilitator should be identified in the annual report and a statement made as to whether they have any other connection with the company.
> B.6.3. The non-executive directors, led by the senior independent director, should be responsible for performance evaluation of the chairman, considering the views of executive directors.

The more detailed provisions specify the frequency of the assessment, ranging from one year (Italy, the Netherlands and the United Kingdom) or two years (Luxembourg). In France, the evaluation should be performed as follows:

> Once a year, the Board should dedicate one of the points on its agenda to a debate concerning its operation.
>
> There should be a formal evaluation at least once every three years. This could be implemented under the leadership of the appointments or nominations committee or an independent director, with help from an external consultant.
>
> The shareholders should be informed each year in the annual report of the evaluations carried out and, if applicable, of any steps taken as a result.

Moreover, the United Kingdom and France both have a recommendation to involve an external consultant at least every three years.

It appears that board assessments are more effective when the corporate governance codes also detail the *objectives* of the evaluation process. In France, Italy, the Netherlands and the United Kingdom, the code provisions specifically recommend to gain insight into the composition and diversity of the board (see also *Figure 4*).

The assessment of individual board members is recommended in France, Italy, Luxembourg, the Netherlands and the United Kingdom. The principles in France and the United Kingdom mention that due to his or her special position, the evaluation of the performance of the chairman of the board needs special attention.

The more detailed code provisions also cover the disclosure of the results of the evaluations. Particularly, the corporate governance codes of France, Italy, Luxembourg, the Netherlands and the United Kingdom provide for publication in the annual report.

Frequent assessments of boards and their members have become the norm in the European countries with more detailed provisions in their corporate governance codes. This practice is also gaining momentum in countries in Asia, Africa and South America.

For instance, in respect of listed companies, the corporate governance code in Singapore recommends a formal assessment of the effectiveness of the board as a whole and the contribution made by each director. The nominating committee is in charge of the evaluation process. Similar to the European countries, the annual report contains the most important takeaways from the assessment. Another recommendation in the code in Singapore is that objective performance criteria are put together by the nominating committee.

An annual evaluation process is also included in the corporate governance code of South Africa. The results should be disclosed in the integrated annual report. Self-assessment by the board is the common practice, Yet, similar to the United Kingdom, the code recommends the use of an external consultant at least every three years.

Figure 4. Comparative Overview

	France	Italy	Luxembourg	Netherlands	United Kingdom
When	Annually (Formal evaluation once every three years)	Annually	Every two years	Annually	Annually
What	The composition of the board Dynamics The individual contribution of each director Chairman of the board	The composition of the board Dynamics The individual contribution of each director	The composition of the board Dynamics	The composition of the board Dynamics The individual contribution of each director	The composition of the board Dynamics The individual contribution of each director Chairman of the board
Who	Nomination Committee/ Independent director (with help of an external consultant)	The Board (Chairman)	The Board	Chairman	Independent directors (external consultant once every three years)
How (Disclosure)	Annual report	Annual report	Annual report	Annual report	Annual report

Source: Authors' research

The 2016 edition of the *Code of Best Practices of Corporate Governance* of Brazil contains a detailed board evaluation provision that covers most of the discussed best practices in the other countries. It is expected that these principles will improve board effectiveness in the long-term in Brazil:

> *Principle*
> The evaluation of the board and board members contributes to the effectiveness of the body, is part of its accountability duties, and allows a greater level of governance in the organization.
>
> *Practices*
> In order to properly evaluate the board, its members must be committed to identifying the strengths and improvements of each board member individually and of the board as a collective body.
> The board is responsible for disclosing information on the evaluation process and a summary of the main points of improvement identified for the body and the corrective actions implemented, allowing shareholders and other stakeholders to have a proper understanding of its operations.
> The by-laws/articles of incorporation must define the specific number of tolerated absences in meetings before the board member is removed from office.
>
> *Approach and Scope*
> The evaluation of the board may be carried out by board members, who may be aided by executives, other stakeholders and/or external advisors. The board of directors and its members must also undergo a self-evaluation (respectively, as a body and as members), as well as evaluate all other bodies that report to the board of directors. At more advanced stages of maturity, the board may also be evaluated by the executives.
>
> The scope of the evaluation should include:
>
> - the board itself, as a collective body;
> - committees, if any;
> - the chairman of the board;
> - board members, individually;
> - the governance secretariat, if any.
>
> The evaluation criteria for the board should include its duties, structure and operating processes. As with the board itself, its evaluation process evolves as the organization's governance system matures.

3.2.5. Countries with Board Evaluation Rules and Regulations

Most researched countries provide recommendations in their corporate governance codes, based on a "comply-or-explain" principle. Deviations from the recommendations to assess boards, committees and board members are thus possible, if explained in an accurate manner.

India, Spain and the United States are countries that have a legal obligation to annually conduct board evaluations. In Spain and the United States board effectiveness assessments are a common practice among major listed companies.

Consider the United States, listed companies are required to conduct an annual performance evaluation of the board under the NYSE listing rules. The rules state that the "board should conduct a self-evaluation at least annually to determine whether it and its committees are functioning effectively." The audit, compensation and nominating and governance committee must also conduct an annual performance evaluation. What is interesting is that companies listed on NASDAQ are not required to engage in self-evaluations, but still do so as a matter of good practice.

The evaluation process is widespread in the United States**.** In 2015, 98 per cent of the boards of the *S&P* 500 companies have disclosed annual performance evaluation results regarding the full boards. Full board including committees were evaluated in 52 per cent of the cases. "Only" 33 per cent of the *S&P* 500 companies assessed the full board, committees as well as the individual directors. Yet, the trend to evaluate the individual director is increasing.

In general, "overseeing the evaluation of the board and management" is a responsibility of the nominating or governance committee. The boards themselves are responsible for the evaluation methodology, such as the use of written surveys, questionnaires and/or interviews. The boards must also determine who will lead the evaluation process (e.g., the Chair, lead independent director or an external consultant).

The regulatory requirements in India are generally in line with the regulations and practices in the United States. The Companies Act 2013 requires listed companies to disclose the annual evaluation process regarding the board, its committees and the individual directors. The nomination and remuneration committee is responsible for carrying out the evaluation of each director's performance.

Moreover, the Securities and Exchange Board of India (SEBI) Listing Obligations and Disclosure Requirements Regulations, 2015 require the evaluation of the performance of the individual directors, including the independent directors and chairperson, on the board and the board's various committees. The entire board must participate in the evaluation of each independent director, except, of course, for the director being evaluated.

The mode, manner and evaluation criteria must be defined (and disclosed) by the nomination and remuneration committee. The full board is required to monitor and review the evaluation framework for the board of directors.

The fact that the Institute of Companies Secretaries of India (ICSI) published a *Guide to Board Evaluation* in April 2015 helps companies to comply with these new rules. The following evaluation criteria were recommended by ICSI: (1) an analysis of the time spent by the board in considering matters, (2) an assessment whether the terms of reference of various committees set up by the board have been met, and (3) assessing the compliance with the Companies Act. Finally, ICSI has recommended the involvement of external experts in the evaluation process.

Even though board evaluations are still in a nascent stage in India, the mandatory rules and regulations led to a number of improvements in the evaluation and disclosure practice of listed companies in India. A report of the Institutional Investor Advisory Services (LiAS) in collaboration with the National Stock Exchange of India Limited (NSE) shows that 84% of the surveyed companies evaluated their individual directors in 2016 (compared to 81% in 2015). 83% of the board committees were evaluated (compared to 78% in 2015). The evaluation of chairpersons increased from 59% in 2015 to 64% in 2016. Also, more companies disclosed the evaluation criteria in 2016.

Even though the compliance rate in India appears to be impressive (particularly compared to other jurisdictions), there is still ample room for improvement. For instance, "only" 8% of the surveyed companies used external experts to assist in the evaluation process.

It is thus not surprising that the SEBI issued a *Guidance Note on Board Evaluation* in January 2017. Its purpose is to educate the listed entities and their board of directors about the evaluation process.

The *Guidance Note* includes detailed recommendations and suggestions on how to conduct a proper and evaluation process. For instance, it contains indicative evaluation criteria in the following areas: (1) the structure of the board, including the competence and experience of the individual directors, (2) the meetings of the board, (3) the independence of the board and (4) the compliance, governance and strategy functions of the board.

The *Guidance Note* also describes methods to conduct the evaluation. It offers guidance for internal assessments as well as assessments performed by external experts. Detailed questionnaires or interviews are mentioned as the main techniques for evaluating a board and assessing its members.

India's approach to offer more detailed guidance appears to be a move in the right direction to increase awareness and, more importantly, acceptance of the board evaluation process. The next section will assess this approach and describe what lawmakers, regulators and companies can do to make sure that the assessments improve board effectiveness. It is argued that boards derive most value from a board evaluation that is shaped by four best practices.

4. "Good Practice"

Board evaluation has attracted increased attention from investors, regulators, and other stakeholders. The reason for this is simple. When done properly and effectively, board evaluations can provide a vital tool for directors to review and improve board performance. This will eventually lead to significant value creation opportunities for firms. Our intention here, however, is to ask whether increased regulation and regulatory guidance *requiring* board evaluation a realistic or a sensible move? This research seems to indicate that companies that are listed in countries with more specific principles and guidance do tend to adopt a more substantive and accessible board evaluation practice than their counterparts/peers in jurisdictions with no or less detailed requirements. This does suggest "law matters" in this field.

The questionnaire survey confirmed this trend. The reporters, who stated that no detailed or explicit rules regarding board evaluations were available in their respective countries, also described the lack of an "evaluation culture" in the boards of directors or supervisory boards. What is interesting, however, is that this culture is less developed in strong "two-tier" countries. A possible explanation could be that boards with more direct interaction with executive management and involvement in determining business strategy and growth targets (as is the case in one-tier board systems) have a more profound interest in "evaluation" and in "improving board effectiveness."

So, what could policymakers and regulators do to make sure that boards get the most out of their evaluations? How can they help promote a culture in which boards, committees, and their members are all genuinely committed to meaningful evaluation intending to improving board effectiveness? It appears from this research that the most valuable and useful board assessments are built around four fundamental principles. These principles offer answers to the following questions:

- *When* should a board be evaluated?
- *What* should be evaluated?
- *Who* should conduct the board evaluation?
- *How* should the evaluation be disclosed/reported?

4.1. Good Practice I: *When* Should a Board Be Evaluated?

The most common practice is for boards to evaluate themselves on an annual basis. It follows from most countries' experience that it makes sense to specify the frequency of the evaluation. And yet, in considering this issue, it is important to realize that there is no "one-size-fits-all" blueprint for the evaluation of the board of directors, including the timing of such evaluations. Board requirements and the evaluation needs of a firm are all firm-specific and vary across life-cycle stages, sectors, and cultures.

For instance, it is only to be expected that if a company seeks to expand to emerging markets, board evaluation is necessary to assess whether more international experience and local knowledge of new markets are required on the board. Board evaluation must be dynamic and responsive to changes in a firm's strategy, operations, and performance.

To give another example. Companies and their boards tend to evaluate and address board composition and diversity issues when they encounter difficulties of some kind. It makes good sense to add independent directors with more economic and financial skills to the boards of companies with accounting problems, for example, during such turbulent periods. For example, the accounting issues that *Groupon* experienced in their post-IPO phase confirms this conclusion. To address quickly criticisms of its financial reporting practices, *Groupon*'s board evaluated itself and appointed two new directors with extensive experience in accounting and finance issues. In this way, dynamic self-evaluation facilitated a swift and appropriate response during a period of difficulty.

Moreover, the board of companies with a disappointing stock price performance may also find it valuable to assess their performance and effectiveness. Our research suggests that to improve market acceptance and investor confidence, boards will usually evaluate immediately and appoint board members with specific market or sector expertise.

This practice indicates that boards of directors may need to conduct evaluations more than once a year. In fact, they would be better served by assessing their performance through a constant process of continual evaluation. The *reporting* of evaluation may only be necessary once a year, however.

4.2. Good Practice II: *What* Should Be Evaluated?

The regulatory approach in most countries is to include the board, its members (executive, non-executive and independent members) and board committees in the evaluation process. As already discussed above, these evaluations need to move beyond the current focus on formalistic compliance and risk management matters. Organizational design within large firms needs to be re-directed to innovation, products, and people.

In a digital and globalized world, boards should facilitate an environment that offers the best chance for their companies to retain the "best" talent, deliver the "best" products and maintain the capacity to continually re-invent itself in the face of rapid technological, economic and social change. The key then is to identify and implement processes that maximize opportunities to deliver more meaningful and relevant strategic advice to management and other stakeholders "in" a company. This is not to suggest that compliance doesn't matter. But, instead, indicates that a broader range of considerations needs to be incorporated into the evaluation exercise.

As indicated in *Figure 2* above, every evaluation exercise needs to integrate and reflect all "four dimensions:"

1. The quality of the monitoring and risk-management role.
2. The quality of the strategic and other business-related advice.
3. The board dynamics and board members' pro-active participation.
4. The diversity of the board.

4.3. Good Practice III: *Who* Should Conduct the Evaluation?

Essential to an effective evaluation is that boards adopt and implement a robust process to evaluate themselves and its members/committees. In principle, achieving this goal requires that all board members need to be involved and engaged with the process.

This recognition of the importance of all board members being involved should not be taken to mean that all hierarchy is to be eradicated and nobody takes the lead. A "kitchen table" approach to the evaluation process is not the solution. Some structure and discipline need to be imposed. For instance, the chair, lead independent board or board committee (usually the nominating committee) should be made responsible for managing the process. They should drive the process, involve the right people (including third-party consultants, when necessary), and make sure that their colleague-directors are actively engaged. They may also deliver feedback to individual directors if the board is not working with a third party or software application to facilitate the process.

Indeed, what is often ignored in the regulatory discussion is the potential use and importance of software solutions and applications to enable more effective board evaluation processes. Exploiting new technologies to manage the extensive data generated by current board evaluation is another area that needs further study. Regulators seem well-placed to offer support and advice regarding the technical aspects and possibilities of evaluation today.

The leader of the evaluation process also needs to manage expectations about the process and the potential benefits that it may bring. Everyone needs to understand that evaluation is not a panacea to a firm's problems and that, although necessary, it is only one element in a firm's strategies for developing its operations.

Often, a questionnaire (with multiple-choice and open questions) dealing with the issues mentioned above is sent to each board member with additional items for committee members and specific questions for the board chairman. Subsequently, individual interviews are conducted by the leader of the board evaluation process to allow board members to express their views freely. The leader of the board evaluation process then provides a report (on an anonymous basis) to the board of directors/supervisory board, including an action plan and areas for improvement.

Here, it should again be noted that there is no "one-size-fits-all" blueprint for the evaluation process. Regulators should be careful with issuing rules, regulations, and guidelines that contain forms and procedures for conducting evaluations. They run the risk of confusing and frustrating the evaluation process. For instance, a rule or guideline to use questionnaires may be construed as a test for board members, which they can "pass" or "fail." This might sound far-fetched, but this sort of confusion often dominates the discussions about board evaluations.

The same confusion can be observed in the discussions about the use of external experts. Who are these experts? Should these experts be certified as “board evaluators”?

Regulators should make clear that there are different ways to conduct the evaluation process, but should also provide options to companies and boards to assess what works best for them. Take for example the reference to board evaluations in *The New Paradigm, A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth*:

> Ongoing candid assessments of director, board, and committee performance are a necessary tool in evaluating the effectiveness and determining areas for improvement. There are a variety of approaches to formulating an effective evaluation process, and the board should not feel compelled to adopt any particular form of board review. Many consulting firms have published their recommended forms and procedures for conducting evaluations and have established advisory services in which they meet with a board and committee members to lead them through the evaluation process. While these services may be helpful, it is not required that the board receive outside assistance or that multiple-choice questionnaires or essays be the means of evaluation.

4.4. Good Practice IV: *How* Should Evaluation Be Disclosed?

Our empirical study suggests that “law does matter” and that the requirement to disclose information about the “board evaluation process” does have a positive effect. Here we do not refer to the disclosure of the individual assessments of board members. Personal and confidential information should not be publicly disclosed. Investors and other stakeholders appear to appreciate hearing about the assessment process. They are interested in the “why,” “what” and “how” of the evaluations. They are even more interested in the “story” behind the board, namely, where do they come from, where are they now, and (most importantly) where are they going.

But, at the same time, these disclosure requirements seem to have resulted in a standardization of how the information is presented. The current regulatory approach appears to breed a formalistic style of compliance. This usually reveals little about the actual mechanics of the evaluation process and the results and takeaways from the most recent evaluation. Also, companies tend to use the same statement (with only some minor changes) every year.

There are exceptions, however. Some firms do embrace a more open style of communication regarding their evaluation procedures, criteria, and methods. An illustration of “best disclosure practice” in this regard is *Randstad*’s statement in its annual report 2015 (see *Figure 5*). The statement contains an action plan that enables investors and other stakeholders to review the process on a year-on-year basis. It also makes it possible to keep track of improvements and issues.

Figure 5. Disclosure of Self-Assessment – Randstad

Induction, training and performance assessment

Ongoing education is an important part of good governance. New members of the Supervisory Board attend induction sessions at which they are informed on the financial, reporting, risk & audit, HR, marketing, legal, and governance related affairs of the Company. Members of the Supervisory Board regularly visit Randstad's operations to gain familiarity with senior operational and functional management and to develop deeper knowledge of operations, opportunities, and challenges.

At a separate meeting held in December 2015, the Supervisory Board discussed at length its composition, its own performance, and that of its three committees. For the first time, this self-assessment was facilitated by an external advisor, Aberkyn. In preparation, each member completed an online questionnaire. In addition, Aberkyn's facilitators also conducted one-on-one meetings with each member of the Supervisory Board, as well as with each member of the Executive Board and some corporate staff, in order to include their individual anonymous observations in regard to the functioning of the Supervisory Board and its relationship with the Executive Board and other stakeholders of the Company. Items assessed and subsequently discussed by the Supervisory Board during the meeting held in December 2015 included (1) team effectiveness, (2) interaction and dialogue, (3) content-related effectiveness, (4) relationship with the Executive Board, (5) effectiveness of the Committees, (6) effectiveness of the individual members, and (7) effectiveness of and engagement with the organization.

The Supervisory Board concluded that the large majority of these items were assessed positively. Team spirit is considered strong, encouraging mutual trust, open discussion, and clear understanding of each board member's role. The functioning of the Supervisory Board during the past two years has been influenced by the changes in the leadership during this period, with the CEO transition in 2014 and the appointment of Wout Dekker as Chair of the Supervisory Board in April 2015. At the same time, two new members, Barbara Borra and Rudy Provoost, joined the Supervisory Board. For the two Boards, this period can be defined as one of finding a new balance, both with regard to the functioning of each Board and with regard to the Boards' mutual relationship. In 2015, the new Chair continued his initiative of 2014 (then as Chair of the Strategy Committee) for a strategic retreat of the two Boards. All participants are very positive about the results of this strategic retreat in terms of openness and depth of discussion. Both Boards want to develop this process further in order to create professional and effective cooperation. The effectiveness of the Committees is good, although there is some scope for optimization. The new Chair and the quality of support are highly valued. Some of the key findings and points for follow-up are:

- The Supervisory Board is growing in its advisory role, but further improvement could be realized through in-depth discussion and exchange of ideas about specific topics, strategic subjects, and dilemmas faced by the Executive Board.
- In both Boards, there is a need to ensure diversity in terms of international influence and expertise.
- The Supervisory Board aims to develop its knowledge agenda on external developments, further encouraging a learning mindset for the organization.
- The Supervisory Board will design a more structured performance evaluation and feedback process for the individual members of the Executive Board and will pay more attention to leadership development and succession planning.

This year's self-assessment process was highly valued by the members of the Supervisory Board.

Source: Randstad's Website

Regulators need to make clear that adopting a detailed and open style of communication can improve a board's ability to provide more meaningful disclosure to stakeholders, inside and outside the firm. Regulators must make more effort to support, encourage, and persuade boards to recognize the rewards that come from the open disclosure of the evaluation process. And the potential rewards do seem clear. At the very least, open communication of evaluation can increase the commitment and engagement of board members to participate in the (future) evaluation process, which will, in turn, improve the functioning and performance of the evaluation and the board.

5. Conclusion

The board evaluation process is not just another formality in the corporate governance of a company. As stated in the *G20/OECD Principles of Corporate Governance*, boards should regularly carry out evaluations to appraise their performance and assess whether they possess the right mix of backgrounds and competencies. To improve board operations and the performance of its members, an increasing number of jurisdictions now encourage companies to engage in voluntary board evaluation. However, this research suggests that the following vital issues need to be considered:

- Board evaluations need to be a continuous and on-going process. There is "no one-size-fits-all" solution, and the design of the evaluation should meet the needs of the individual company and the particular circumstances of that company.
- Board evaluation needs to be based on and include the assessment of both the committees and individual board members (executive, non-executive and independent directors).
- The evaluations should include not only compliance and risk-management competencies, but also skills and experience in business-related and organization-related areas, such as strategy, innovation, marketing, globalization, and growth.
- Board dynamics, processes should also be on the "evaluation agenda."
- The evaluation process should assess the composition and diversity of the board.
- "Best practice" principles, rules, and regulations should provide enough detail to help companies implement and conduct adequate evaluation processes, but also leave enough flexibility for companies to tailor the process to their specific needs.
- Additional guidelines could provide more information about the criteria, methods, and form of the evaluation process (without compelling the companies to make use of them).
- Additional guidelines could also be used to update the companies and their boards about any new developments and trends in the field of board evaluations.
- The board member or committee driving the evaluation process should actively involve external experts if - and when - necessary.
- Board evaluation software and applications can help facilitate the assessment process.
- Boards should engage in a more open and detailed form of communication about the evaluation process and its outcome. The disclosure should contain an action plan.

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