Board evaluations

Making governance effective
In this session we will:

• review international trends in evaluating board effectiveness

• consider:
  – King III,
  – Companies Act 2008,

• consider what makes boards and committees effective and how to assess them

• discuss assessment of the Chairman, CEO and individual board members

• consider in-house vs external evaluations
But first, let me ask you
Have you ever taken part in a board evaluation exercise?
What was the result?

• Afterwards, did things improve?
• Did they get worse?
• Did the board learn from the exercise?
International trends

- UK Financial Reporting Council
  - Guidance on board effectiveness
- New York Stock Exchange
  - Listed company manual
- France
  - Principles for the corporate governance of listed corporations
“Boards continually need to monitor and improve their performance. This can be achieved through board evaluation, which provides a powerful and valuable feedback mechanism for improving board effectiveness, maximising strengths and highlighting areas for further development. The evaluation process should aim to be objective and rigorous.”
UK Guidance

• Adapt evaluation for each board
• The chairman should be in charge
• The senior independent director should lead the evaluation of the chairman
• Board committee evaluations should be led by their chairmen
• Constructive feedback is crucial
Annual performance evaluation of the board:

The board should conduct a self-evaluation at least annually to determine whether it and its committees are functioning effectively.
France

(the AFEP-MEDEF code)

Principles for the corporate governance of listed corporations

_EVALUATION OF THE BOARD OF DIRECTORS_

“the Board of Directors should evaluate its ability to meet the expectations of the shareholders” by reviewing its:

- Membership,
- Organisation
- Operation
- Committees
- Prioritisation
- Actual contribution of each director
So, what is a board and why does it matter?
King III

- ‘Companies should be headed by a board that directs, governs and is in effective control of the company. Every board ... should meet as often as is required ... preferably at least four times per year.

- The board should ... (monitor) relationships between the board and management ... the company and its stakeholders.

- The board’s paramount responsibility is ... creating value ... (while) consider(ing) the legitimate interests and expectations of all its stakeholders.

- The board should exercise leadership, enterprise, integrity and judgement in directing the business of the company so that it can survive and thrive.’
Section 66(1)
The business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that this Act or the company’s Memorandum of Incorporation provides otherwise.
The Act does not describe how a board should be made effective – but deals with legal powers, duties and liabilities of directors.

- Section 75 – Directors’ personal financial interests – recusal of interested directors
- Section 76 – Standards of directors’ conduct – codification of common law
- Section 77 – Liability of directors - codification
Why should we evaluate our board?
Why should we evaluate our board?

1. Because it is expected of us by King III
King III

The board should act as the focal point for and custodian of corporate governance

*Principle 2.1*

The evaluation of the board, its committees and the individual directors should be performed every year

*Principle 2.22*
Why should we evaluate our board?

2. Because it is required of us by JSE listings requirements
8.63(a) A company must disclose in its annual report:
“(i) a narrative statement of how it has applied the
principles set out in the King Code, providing explanations
that enable its shareholders to evaluate how the principles
have been applied; and
(ii) a statement addressing the extent of the company’s
compliance with the King Code and the reasons for non-
compliance with any of the principles in the King Code,
specifying whether or not the company has complied
throughout the accounting period with all the provisions
of the King Code, and indicating for what part of the
period any non-compliance occurred”
Why should we evaluate our board?

3. Because it will help us to manage the risks of being a director by improving board effectiveness
Directors’ liability

A director of a company that employs thousands, deals with millions of customers and does business in billions of rands
May become liable for a breach of:
• Fiduciary duties, or
• Companies Act requirements
By attending 4 meetings for 24 hours a year
Directors’ liability

A director can avoid liability under the new Companies Act (section 76(4)) if he:

• diligently informs himself about the matter
• has no material interest, or complies with section 75
• takes rational decisions, believing them to be in the best interests of the company
• relies upon employees whom he believes to be competent
• relies on:
  – professional advice
  – board committees of which he is not a member unless he has reason not to have confidence in it
Directors’ liability

Regular evaluations of the board, its members and committees can:

• pinpoint weaknesses
• suggest remedies
• give comfort regarding board processes and actions
• be evidence to refute allegations of negligence
“What gets measured, gets managed”

Peter Drucker
How do we go about the evaluation?
Evaluation process

- Use questionnaires to identify issues
- Interview directors to probe issues in more depth
- Collate and summarise results
- Report initially to chairman (and committee?)
- Feedback and discussion with the full board
- Action plan to remedy deficiencies
Evaluation process

• Start with the board:
  – Capacity
  – Processes
• Committees – guided by committee chairs
• Chairman – guided by the lead independent
• Individual directors – guided by chairman
Assessing board capacity

- skills, experience and diversity to face challenges
- clarity and leadership around strategy and values
- succession and development plans
- how the board works together
- tone set by chairman and CEO
- key board relationships:
  - chairman/CEO
  - chairman/lead independent director
  - chairman/company secretary
  - executives/non-executives
Assessing board processes

- quality of information to directors on company performance
- quality of papers and presentations
- rigour of discussions on individual proposals
- does the chairman ensure enough debate on major and contentious issues?
- how well committees connect with the main board
- processes for identifying and reviewing risks
- how the board communicates with shareholders and other stakeholders.
Assessing committees

• Audit:
  – A host of statutory and King III responsibilities

• Risk
  – A stand alone or combined committee

• Remuneration
  – Detailed King III recommendations

• Nomination

• Social and Ethics – including:
  – Safety and environment
  – HR and transformation
  – Corporate citizenship
  – Social and economic development
  – Consumer relationships
Assessing individual directors

• effectiveness of individual directors (both executive and non-executive) in:
  – grasping strategic issues facing the company
  – keeping abreast of current developments
  – adhering to company values
  – showing leadership on matters within their expertise
  – encouraging other directors to contribute
  – etc

• effectiveness of the lead independent director:
  – clarity of his/her role
  – competence in performing the role

• effectiveness of the secretariat
In-house vs external assessment

For those of you who have taken part in board evaluations:

• Were they done in-house? - or

• Facilitated by an external person?

• For those who had both, which worked better?
In-house vs external assessment

- UK guidance for larger listed companies requires external facilitation every three years
- My experience is that internal evaluations can be superficial – although they are cheaper
- External facilitators must be carefully selected but can add value
- External facilitators allow you to learn from experience of others
- Assessment tools for in-house use are available on IODSA website and elsewhere
Board evaluations

• Can improve your board’s effectiveness
• Are here to stay
• Use them!