
BOARD OF DIRECTORS EVALUATION MODEL

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There is not a single model for Board of Directors evaluation since it must represent the reality of different companies in different industries and in different regions.

Nevertheless there is a common ground to be represented in the model, since we are working in a Global Economy, with shared values and a tendency toward standardization in areas such as Management, Quality, Accounting, Quality Awards, IT, etc.

In this sense it is important to note that significant work have been made which can be used as a guide when working on this subject, and is expressed in:

The 10 Corporate Governance Drivers (See Appendix A)

- 1) Good for Business
- 2) CG Institutes on Universities
- 3) Roundtables IFC/OECD/CGPSF
- 4) Directors Associations
- 5) National Quality Awards
- 6) Regulators: government & markets
- 7) Stock markets
- 8) Rating agencies
- 9) Investors & Banks

10) Independent Directors

The model should be constructed not only with this framework in mind, but also representing those areas of differentiation that we consider a must for the competitiveness of the company in the long term, that is to say it must be “**Good for Business**”, as previously stated.

The model is an instrument, key to our improvement efforts, clearly representing where we are today and where we want to be tomorrow.

Taking this into account, we established the Criteria under which the expected behaviors of the BOD, or outcomes from the BOD, are represented. For each factor in each criterion we’ve developed a statement that is a representation of excellence.

At evaluation time and for each factor a comparison of the present situation of the Entity and that statement should be made. Five different levels of accomplishment are also described, which helps in selecting the right one, which in turn carries on a numeric value: the result for that factor, in a scale that has a minimum and a maximum.

This maximum value is very important since it represents the weight of the factor in the criteria.

Criteria for Board Evaluation

The Criteria are the basis for Board evaluation and self-assessment to help improve performance practices, capabilities and results.

Core values and Concepts

The Criteria are built upon the following set of interrelated Core values and Concepts:

Leadership

The Board should set directions with high expectations and clear and visible values, aligning the interests of all stakeholders to support and guide the decision making of all members of the organization.

Ethics & Transparency

The Board should ensure ethical behavior and compliance with laws and regulations, auditing, and accounting principles.

Difference between Governance and Management

Board independence from management is crucial to ensure that the Board effectively carries out its mission and responsibilities and holds management accountable to shareholders fairly

Board effectiveness is reduced by the failure of board members to think through and understand the distinction between governance and management. The main functions of the Board are to effectively:

- Ensure the strategic guidance of the company, and
- Monitor its management.

The roles of Directors and Managers must be defined assuring that execution is clearly a Management responsibility.

Focus on well documented processes that add value

Corporate Governance must be good for the company business by creating value for all stakeholders. This should be the guidance for the selection of Board Best Practices. All items in this Board Evaluation Approach require formal, transparent, and well-documented written processes.

Focus on results

Although all the above items are necessary, they must be focused on desired results, avoiding exclusive considerations to procedures, tools or internal structure, which are only means used to achieve the desired end.

Criteria Categories for Board Evaluation

Seven Criteria Categories were established and subdivided into items as follows:

- 1- **Mission and Principles**
- 2- **Board structure**
- 3- **Board operating procedures**
- 4- **Board & Management**
- 5- **Board & Shareholders**
- 6- **Board & Stakeholders**
- 7- **Board contribution**

General comments on each criteria category:

1. Mission and Principles

The Mission of the Board

The BOD is responsible for the professional development of the Company's Mission insuring Management participation and its full deployment within the Company.

The basic mission of the Board should be to ensure the strategic guidance of the company and the effective monitoring of management.

The BOD also must insure that the Principles of the Company are integrated into its daily activities, at all levels, and form part of the Corporate Culture.

Legal framework – Liabilities

The legal framework is defined by the company statutes, law doctrines and organizational documents that define duties and liabilities in the jurisdiction where the company is organized, and must comply with the letter and spirit of the law.

The Company must also consider its own commitments to different stakeholders as an integral part of its compliance system.

Code of Corporate Governance Best Practices

This document should include rules and procedures for Board and Company operations that assure compliance with laws, regulations and OECD Principles for Corporate Governance. Key success factors are: transparency, accountability, integrity, communication, fairness, independence, credibility, honesty, and mutual respect.

The Code should include only what is needed by the company to accomplish its business objectives.

2. Board Structure

The composition of the Board varies depending on the needs of the Company. It is not possible to formulate or design a model Board that would represent the best solution for even a small proportion of companies.

Board size

Boards should be small rather than large, but should include diversity of backgrounds in order to ensure at least two different ways of tackling problems. In other words, understanding something from at least two angles, since seeing a problem from just one viewpoint is a rather fragile kind of understanding.

A Board should have a majority of independent directors with a wide range of talents, expertise, occupational and personal backgrounds.

Avoiding too big Boards (that usually become too speed Boards where it is difficult for each member to make effective contributions, and even more difficult to make decisions) is recommended.

Chairman - Lead Director

The Chairman controls the environment within which governance takes place, ensuring effective meetings with free and focused discussions.

It is the Chairman's task to turn a group of capable individuals into an effective Board team.

In order to ensure effective company leadership directed by an effective and accountable Board, it is advisable that the Chairman and CEO are not the same person. When this is not the case, the Board should designate a lead director to Chair independent directors' meetings to discuss items such as compensation, auditing and governance.

Mix of inside and external independent Directors

The number of independent directors should assure strong independent opinions in Board meetings, increasing in this way the "knowledge base" of the board.

Board committees

The functions performed by Board committees are important to effective governance.

Boards that are too small to have committees must perform committee functions.

The most common Board Committees are Auditing, Compensations and Governance.

They should consist of a majority of independent directors in order to assure strong, independent, and transparent opinions in critical business areas.

Committee functions and processes should be clearly established and communicated to all those involved.

3. Board Operating Procedures

How to select new members

Boards should seek candidates with the skills and capacities that meet the needs of the business.

They must be defined taking into consideration, age, personality, education, candor, experience, languages, commitment, availability, and the ability to challenge without confrontation.

The core competencies of the Board are:

Accounting and Finance

Business judgment

Risk Management

Crisis response

Industry knowledge

International markets

Leadership

Strategy/Vision

Directors should have a basic knowledge of the statutes, law doctrines and organizational documents that define their duties and liabilities as directors in the jurisdiction where the company is organized. They must not only know the letter but also the spirit of the law.

Definition of independence

Outside directors are independent when they:

- have never been employed by the company
- are not related to any company employee
- are not employed by any firm that provides major services to the company, and receive no compensation from the company other than director fees.

Outside directors need to be more than independent; they must be independent-minded as well

Directors Function Description

All members of the Board and the Chairman should have an updated function description.

Training and orienting directors

The Board should have an adequate process for orienting and educating new directors, as well as training all the members of the Board.

Meetings, agenda, minutes and follow up

The Board should have an established schedule of meetings. Business needs might require the Chairman to call for special meetings. The agenda and all relevant information should be provided well enough in advance of meetings, to be reviewed carefully beforehand. Minutes should be precise and should focus on actions and decisions.

Election term/ Term limits/ Mandatory retirement

All three issues should be clearly established and respected.

Exceptions require approval.

Board compensation review

Compensation for directors and the process to review directors' compensation should be appropriate.

Participation of Senior Managers and other non-directors in meetings

The Board should provide appropriate advice and counsel to senior management. Senior management should be invited to participate in Board meetings when necessary. The CEO should participate in all Board meetings.

Board and Director Assessment - Self-assessment

The Board should have an effective process to assess its own performance.

4. Board and Management

Formal evaluation of the CEO

The Board should have a formal process to evaluate the CEO.

Senior management compensation

The Board establishes senior management compensation and relates it to their performance.

Board access to senior management

Individual discussions between the CEO and the directors should be frequent and there should also be periodical meetings with other senior managers such as the CFO and COO.

CEO succession planning

The Board adopts and maintains a senior management succession planning process to its satisfaction.

Effective/Efficient generation of strategies and its full deployment.

This is key to Company success and the BOD must be instrumental to this achievement.

HoshinKanri is the perfect methodology in this sense and its use is highly recommended.

Company information

The Board should receive reliable, accurate and timely information about company operations. It should be brief and clear enough to be assimilated and understood without undue difficulty, and above all, it must be relevant to the strategic issues the company faces.

Risk assessment and risk management

The Board should review and discuss periodically company policies and compliance systems including security, IT related safety, auditing and others, depending on the kind of business.

Clear definition of Board and top management roles

The roles of Directors and Managers must be defined assuring that execution is clearly a Management responsibility.

Management recommends and implements. The Board approves vision, mission, strategies, major projects and budget, and conducts frequent, consistent and disciplined follow-up to ensure actions are being taken and improvements are being made.

5. Board and Shareholders**Content and character of disclosure**

The company governing documents should include disclosure to shareholders of information on ownership structure, compensation to CEO and Board members, accounting practices and any other company information needed to guarantee transparency and assure compliance with regulations and protection of basic shareholder rights.

Compliance with basic shareholder rights

All shareholders should be treated equally. They must:

- Obtain relevant and sufficient information on the company on a timely and regular basis
- Participate and vote in general shareholder meetings
- Elect and remove members of the board
- Share in the profits of the company
- Participate in extraordinary transactions such as the sale of a business, etc.

6. Board and Stakeholders

All commitments and interactions with different stakeholders must be made within a holistic view of the company.

Disclosure to the government and community should comply with the law and regulation with emphasis in social responsibility actions. The press, customers, and institutional investors should be kept informed of major issues regarding the Company, the top management, and the Board.

Note: in spite of being shareholders also stakeholders, they have their own chapter (5) due to the specific needs to be considered.

7. Board Contribution

On company results

Successful critical strategies generated and controlled by the board should be evaluated as well as key performance indicators, including intangibles.

General guidelines to assign scores

We recommend following the methodology indicated in the Criteria for Performance Excellence published by the Baldrige National Quality Program. Many countries in the world have National Quality Awards that share the criteria established by the Baldrige Award in the U.S.A. and are written in the local language. It is also highly recommended for Directors to be literate on how companies are evaluated for Quality Awards.

A procedure to evaluate the performance of a Board of Directors should be based on a comparison against a target model that represents the State of the Art, as is usually done in quality award programs. In this work we use the OECD Principles for Corporate Governance, to build the target model.

This model is, in the opinion of the authors, a good representation of what could be expected today in a competitive environment as Contribution from the Board to the Company development and sustainability.

Note: the proposed BOD Evaluation Matrix is an example that covers in general the basic minimum needs of a Company and is provided as a workable example.

Nevertheless it is the continuous responsibility of the BOD to decide additional areas to be considered as a way to really add needed value to the Company.

In which case, a modified scoring system must be implemented either maintaining the 1000 points as a maximum (altering all of the values) or adding the new criteria points to the 1000 basic points.

Considerations in relation to the scoring system: it is important to note that for each criteria

its maximum value represents its relative weight, and this must be specifically considered in relation to the new matrix under development.

Additional areas to be considered can be: IT Governance, Talent Management, Risk Management, or Innovation, for instance.

As an example we provide some basic information related to the possibility of including IT Governance in the already mentioned tool.

Example: IT Governance

The BOD must insure:

- the alignment of IT and Business Objectives
- that a flexible IT infrastructure is present
- that IT total costs are well managed and competitive.
- that risks associated with IT utilization are known, controlled, and eventually mitigated.
- that the Organization Knowledge Management system is satisfactory and in sync with its IT evolution.
- a professional assessment of the contribution of IT to the business, as well as of IT projects careful selection and completion.
- that internal IT customers are using the systems efficiently
- that IT projects are regularly monitored and that any deviation is properly managed
- that the correct information is available at the correct time and in the correct place

Note: In this sense is instrumental to understand that Information Technology is composed by two terms:

Information, which contributes to the Company Competitiveness, and

Technology: which is the support for that Information.

The first is the main responsibility of the CIO (Chief Information Officer) very focused on the competitiveness of the company through Information Management.

The second has to do with the CTO (Chief Technology Officer) tasks and responsibilities.

If those positions are not implemented due to size, the main responsibilities must be performed, within the Company framework, with that conceptual division in mind,

The Matrix

Consistent with the desired model, a matrix was constructed including the seven selected criterion, and five evaluation columns for each of them, which represents the following levels:

- **Level 0:** Not Applicable. Not in use at this moment.
- **Level 1:** Understanding the need to improve Corporate Governance
- **Level 2:** First concrete steps toward establishing best practices
- **Level 3:** Implementation of best practices
- **Level 4:** Leadership

Within each criterion (from 1 to 4), a fundamental description of excellence is provided: **the factors.**

For each of these factors, the BOD under evaluation must decide in which level of evolution they presently are, through a selection of the appropriated level, from 0 to 4.

There is a correspondence between a certain level and a numerical band assigned to it: the factor weight.

Thus, for a certain criteria, a resulting value is obtained and included in the correspondent cell (result).

In doing so for each and every criterion, a final value is obtained as the final BOD EVALUATION, which eventually can be used to compare with similar Organizations, operating in similar environments and using the same evaluation matrix.

Nevertheless, the results for each criteria are an excellent way for analyzing the BOD situation, and its selective progress toward an agreed upon result is the proposed methodology for BOD improvement over time.

Methodology: depending on the factor under evaluation, it is clear that two approaches must be used:

-**Observation:** in which case the evaluation can be obtained using available internal and or external information (documents, notes, statements, and so).

-**Feedback:** in this case, and due to the nature of the needed information, a feedback system must be established in order to gather information from different stakeholders. In order to perform this task a 360° feedback system is recommended, which must be analyzed proposed and adopted.

Note1: Stakeholders include management, personnel, major suppliers, customers, government, investors, society, and controlling and minority shareholders

Note2: Since the evaluation can be performed in quite a wide variety of business environments, we recommend developing a score system at the Company, Country or Region level. This is an important task that in every case should be carried out by a professional committee, depending on the scope of the evaluation.

If a group of Companies or a Region, decides to use this methodology, an independent trusted Entity must be selected in order to provide Professional Evaluations of the participant BODs.

In this case, it will be of great advantage that the selected Institution, also provides the Repository for the analyzed information, in which case and with time, a solid data structure can be constructed, in order to be used as BOD benchmarking.

Factors within the seven Criteria

The presented matrix is just a model and has the flexibility to be modified accordingly to specific needs, as well as political and economic context.

The factors should represent what we want to evaluate in the specific case we are dealing with.

Using the proposed Matrix as a reference, a new matrix can be developed, taking into account the previously made recommendations.

In this way, each factor can be analyzed, deciding on its relevance or not. The factor can be eliminated, or given a different weight. Also new factors, not present in the proposed Matrix can be added.

A well-defined set of factors should be a consequence of company needs, and could consist of a critical set at the beginning of the process, as to facilitate a successful startup.

In this way a new Matrix can be constructed, using the area under MODEL CONSISTENCY as a check page for total points assigned. It is very important to note that these points represent the weight we are assigning to each factor in the evaluation, resulting in this way an integral part of the Model.

The system should be dynamic, dependent on time and geography. As previously commented, the scores and factors in the system must be critically analyzed and eventually updated on a timely basis according to the progress of the Company, Country or Region. Nevertheless in a certain period of time the matrix must be fixed in order to allow periodical evaluations-

As regards the “factors”, special consideration and importance should be given to the “BOARD CONTRIBUTION” criterion. It is the same concept as “RESULTS” in the Countries National Quality Awards; thus, similarly and for the same reasons, it should be given a significant score. The different actions of the board should ultimately be directed toward improving its Contribution to Company Results, and this contribution is shown here.

Appendix A

The 10 Global Corporate Governance Drivers*

There are 10 Corporate Governance Drivers that globally are contributing to improve companies' effectiveness and quality of life of societies.

1. **Success cases.** Good for business. There are many success cases that prove that Corporate Governance Best Practices and a professional BOD is good for the business not only on major companies but also with SME's and family owned.
2. **Roundtables IFC/OECD/GCGF.** The first Roundtables took place in year 2000 as part of an IFC/OECD/GCGF program to provide an effective framework for ongoing policy dialogue and a multilateral exchange of experiences in several regions of the world including Latin America, Eastern Europe, Eurasia, and China. Every year or two since then the Roundtable discussed, agreed and made recommendations on the different subjects related to Corporate Governance. This valuable information including other OECD key documents is published and widely distributed, see the following web page: <http://www.oecd.org/corporate/>
3. **Directors Associations.** Most of the countries have not for profit private organizations grouping Board members and Companies and providing services such as training, publications, relations with international and regional organizations and promoting Corporate Governance with stock markets and investors. The major organizations are the National Association for Corporate Directors (NACD) in Washington, DC and the Institute of Directors in London, UK.

4. **Investors & Banks.** They look at the Governance of a company when evaluating for a loan or investment.
5. **Stock markets.** Good governance ...better stock price
6. **CG Institutes on Universities.** As it is the case with St Galen and IMD in Switzerland and Harvard, Yale and Northwestern in the USA. In an increasing number of universities they have training programs for Directors, research on successful cases and workshops attended by CEO's, Directors and family owners on the various governance subjects.
7. **Independent Directors.** There are an increasing number of trained independent professional directors in all countries. This is a growing new profession.
8. **Regulators: government & markets.** Regulations are being updated in all countries. Laws such as the Sarbanes Oxley in the US or Comply or Explain Voluntary Codes of Best Practices are required for companies quoting in the stock markets. Many countries have now national educational codes that are used as a reference by non-listed companies to develop company codes.
9. **Rating agencies.** Include Corporate Governance practices in their evaluation of companies
10. **National Quality Awards**The Malcolm Baldrige National Quality Award in the US, have under the Leadership criteria questions on the Governance System including social responsibility since 2007. Same now in other countries. This is having a great impact considering that a significant amount of companies around the world use the Award Model for self-evaluation of their performance and that hundreds of evaluators, most of them voluntary professionals of major and SME companies are trained yearly by the Award organizations

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National Association for Corporate Directors

Under Services : Board Evaluation

www.nacdonline.org

OECD Regional Roundtables and Programs (Latin America, Russia, Asia ,etc.)

<http://www.oecd.org/daf/ca/corporategovernance-regionalroundtablesandprogrammes.htm>

International Academy for Quality . Quality in Governance Think Tank

<http://iaqweb.org/thinktanks.asp> (being updated)

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-Chapter 5: An approach to Board of Directors Evaluation

Marcos E.J. Bertin and Hugo Strachan

-Chapter 6: Self-Assessment: Information Technology Governance

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