



Room for improvement on evaluations

Board perspectives



Corporate board proceedings remain among the most closely guarded discussions in American business, but an ongoing focus by investors on director quality and qualifications since the financial crisis has compelled boards to consider greater transparency on issues such as board composition, tenure, term limits, and diversity.

Seeking to reinforce their position as effective stewards of capital, institutional investors have shown greater interest in who serves on the boards of their portfolio companies and how those boards operate, including how they self-evaluate. While it is already the norm in Europe, U.S. investors are starting to demand more information from issuers about the board assessment process.

Two recent surveys on board evaluations and effectiveness, conducted separately by the Rock Center for Corporate Governance at Stanford University and The Miles Group¹ and by Rivel Research Group², show considerable opportunity for improvement in the evaluation process and disclosure.

Dissatisfaction on both sides

The Stanford survey indicated that many directors are dissatisfied with the board evaluation process, particularly the assessment of individual directors. Only 36 percent of directors surveyed believed that their company does a very good job of accurately assessing the performance of individual directors.

Investors held similarly negative perceptions about the effectiveness of board evaluations. A combined 56 percent of investors surveyed by Rivel said that companies do not assess their boards that well or do so “very poorly,” and only 28 percent believe that directors take the evaluation process “very seriously.”

Effectiveness laid bare

Shareholders have long raised concerns about a lack of effective processes to remove underperforming directors and too much collegiality in the boardroom. The Stanford study may confirm some long-held suspicions.

According to the study, only 46 percent of the directors surveyed strongly believe that their board tolerates dissent, only 52 percent believe their board is very effective in dealing with directors who are underperforming or exhibit poor behavior, and 53 percent believe that directors do not express their honest opinions in the presence of management. Moreover, 35 percent said their boards do not have a structured process for removing ineffective directors, only 23 percent rated their boards as very effective at giving direct feedback to directors, and 54 percent said that if they had sole power to do so, they would have one or more of their fellow board members removed.

Making progress

Positive news, however, emerges from both studies. The Stanford study shows that 89 percent of directors believe their boards have the skills and experience necessary to oversee the company and 73 percent say that the individual directors on their board are extremely or very effective. The Rivel study identified industry knowledge/experience (32 percent) as investors’ most essential personal attribute for an ideal board member.

Nonetheless, courage (the ability and willingness to stand up and ask questions) was second (24 percent), reinforcing investor expectations for boards to act as a credible check on management's power.

The Rivel study also showed that, while they would like to see companies disclose additional information about their evaluations, investors took note of recent improvements in disclosure. Investors said that increased disclosure would also be helpful to them in supporting director renomination.

Next steps

The Stanford study demonstrates that even directors themselves believe that there is work to be done to make evaluations more effective and useful. The Rivel study shows that, with respect to evaluations, directors have a credibility problem with investors. For greater impact, boards should strive to demonstrate the seriousness and validity of their evaluation process. A robust process should pull back the curtain on the evaluation methodology and explain how the results will be used.³ Further, boards should improve related disclosure. You can't get credit for having a robust evaluation process if your investors don't know about it.

Efforts to improve board evaluations and disclosure will be a win-win for directors. Not only will it lead to more effective boards, it will aid investor assessment of directors when they are in the proxy voting booth.

¹ David F. Larcker et al., Board of Directors Evaluation and Effectiveness, Rock Center of Corporate Governance, Stanford Graduate School of Business in collaboration with The Miles Group, November 2016. Based on a survey of 187 directors of public and private companies in North America.

² Rivel Research Group, "Disclosure and the Board of Evaluation Process: Where to Proxy Voters Stand Today?" and companion report "Evaluating Board Effectiveness," March 2017. Reports are based on 71 in-depth telephone interviews with proxy voters at North American and European institutions (51 and 20, respectively).

³ For further discussion and recommendations for board evaluations and assessments see: Enhancing evaluations for boards, committees, and directors

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