A studied approach to board assessments and skills matrices

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- The article highlights recent research on the state of board evaluations based on 2014 corporate disclosures across ASX 300 companies.
- A view of the current state of board assessments and skill matrices is presented in excerpts of interviews with industry leaders.
- Contemporary thinking suggests board evaluations should focus on team dynamics rather than individual performance.

'No matter how good a board is, it's bound to get better if it's reviewed intelligently'.[1]

Introduction

Any board of directors or governors in Australia today, whether a not-for-profit (NFP) organisation or a listed entity on the ASX must have a framework to review itself or it cannot stand as a legitimate organ of the organisation it governs. Behavioural psychologists and organisational learning experts agree that people and organisations cannot learn without feedback.[2] Today more than ever, boards need to be 'quick studies' — quick to learn and flexible to adapt to be effective in a world of constant change. Board assessments have been around for a while but are we satisfied they are effective? The answer of 'effectiveness' is elusive. In the management literature the concepts of board evaluations, self-evaluations and self-assessments are used interchangeably.

Overview

The article highlights recent research on the state of board evaluations based on 2014 corporate disclosure across the ASX 300[3] (with special focus on ASX 100 performance). The perspective of the company director is represented in an excerpt from my interview with Mr David Gonski, Chairman of ANZ Bank and Coca Cola Amatil. One aspect of evaluating board performance is on the development of a skills matrix by all ASX listed companies as required by the third edition of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* (Principles and Recommendations). A brief overview is included of the early adopters to this requirement: ASX, Perpetual, Telstra and WorleyParsons. The company secretaries provided some insights into preparing a skills matrix; excerpts of these interviews are included in this article.

Strategy execution

Despite mixed findings on the empirical links between corporate governance and firm performance, there is a discernible and growing belief in the investment community that good governance will enhance corporate outcomes. Large institutional investors, and their proxies, are now very powerful and actively pursue policies that demand more from boards than ever before. They consider that boards can directly enhance shareholder value. This is now driving boards to change their behaviour and improve their corporate governance performance.

Over the past decade and a half expectations have increased the need for boards of directors to demonstrate effective leadership, quality decision-making processes and the ability to exercise corporate controls. Stakeholders continue to focus on indicators such as board structure, composition and non-executive director independence as proxies for effectiveness, often without an increased understanding of the environment in which boards of directors make decisions, or the behaviour and dynamics of individuals on boards.[4]

Subsequent to a host of looming corporate challenges such as: emerging markets; digital disruption; environmental and social impacts and increased reporting and disclosure requirements, boards of directors are facing amplified pressure from all sides in a bid to ensure effective corporate governance.

Corporate strategy is highly sensitive and obscured by a high degree in secrecy. This makes it almost impossible for 'outsiders' to assess the effective guidance of strategy execution by boards. Instead structural governance issues are more easily assessed.[5] The article contributes to the debate for enhancing board assessment and the development of board skills matrices by looking beyond structural governance issues.

Figure 1: Current level of board evaluation disclosure for ASX 100

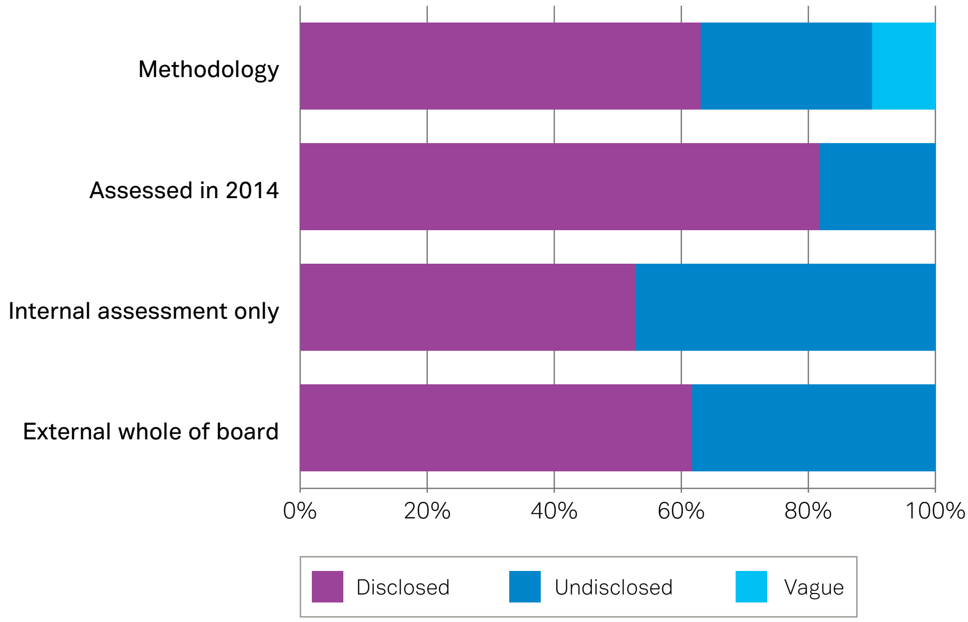

Figure 1 above graphically illustrates the findings of a review board assessment practices across of the ASX 100 for 2014. The focus of the review findings was on the ASX 100 in terms of the method of assessment; whether there was an assessment disclosed in 2014 or not and if it was undertaken via internal means only or externally of the entire board (including committees).

The decision–making environment

This article advocates an enhanced approach to board evaluation. The evaluation process should construe specific influences — company lifecycle, corporate structure and board culture — that affect the environment in which boards make decisions. This means going beyond just compliance, and in undertaking board evaluations chairs should factor these environmental influences when determining the objectives of an evaluation of their board.[6]

Current level of board evaluation in Australia in terms of risk management and corporate strategy

In order to quantify the level to which Australian boards undertake an evaluation process, a thorough review was undertaken of ASX 300 disclosure for 2014 as set out in their annual reports, corporate governance statements and other publicly available material. The focus of the findings in this article is on the ASX 100 rather than the whole ASX 300. The overwhelming majority of listed entities in the ASX 100 undertake board evaluations over a two-year cycle, where the whole board is assessed including committees and or individual directors. These may be internal or external reviews.

The results for the ASX 100 show that 18.3 per cent of the ASX 100 listed entities did not clearly disclose to shareholders and stakeholders whether their board of directors in fact underwent a board evaluation in 2014. The language was vague not only regarding 2014 but also for past years.

Overall 100 per cent of companies disclosed their approach to risk management, corporate strategy and corporate governance, however on a subjective read of the material presented only 20 per cent of ASX 300 companies provided their approach to these topics with exceptional clarity by communicating an '*investment narrative*'.

Other findings were that only 61.7 per cent of boards in the ASX 100 were externally reviewed in 2014 rather than engage an independent adviser/facilitator. Of the 39 per cent that did not engage external parties the task fell to the company secretary, chair or chair of the nominations committee to conduct an internal review as an ongoing common practice and not just for 2014. The prevalence of using external expertise seems to be capped at 52.7 per cent of ASX 100 companies as an ongoing method of review as the findings found that to be the percentage of boards across the ASX 100 that conducted an internal assessment only.

Finally of the 63 per cent that disclosed their methodology for assessment in 2014; ten per cent of the whole did so in a very vague manner. There was a predominant use of self-assessment combined with a one-on-one session with the chair and or chair of the nominations committee as well as the use of an external adviser.

Company director's view: Excerpt from an interview with Mr David Gonski

Further to the review of the ASX 300 and disclosure on board evaluation set out in Figure 1 of ASX 100, a dozen ASX 100 chairs were interviewed by various electronic means — representative

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of these discussions is the following edited excerpt of my interview with Mr David Gonski, Chairman of ANZ Bank and Coca Cola Amatil:

Q: In contrasting board dynamics and assessments from the 1990s to today, what is the single standout paradigm shift you have observed?

A: ….in the 1990s and today we are moving towards assessing boards as teams rather than individuals. In the 1990s when we started assessing, each board director was reviewed as a separate operating item. The initial concept of assessment was to see whether the board member was operating correctly as an individual.

Today if one looks at an individual board member it is imperative that one is looking at him or her in the context of being a team member. To take an example, in the old days if a board member was seen as perhaps too commercial this was seen as a criticism. Today a board member who is too commercial is a negative but only where the board doesn't need a person who serves in that capacity, that is, it could be a good thing that one board member is too commercial because the other board members can use that person as a stalking horse for what is too commercial.

Q: In the current state of play, some directors are calling for a change of approach. Do you see a need for changing the approach to undertaking board assessments?

A: I am very keen on external board assessment based on the team concept. I am absolutely against assessments of the old genre which potentially pitted one director against another, that is, each director was competing either to be assessed the best or to make sure they weren't the worst.

There is a further question of the regularity of both the assessments and who does them. In my view no external party should be engaged to do an assessment more than twice and to do assessments every year is too often. Two to three years would seem a more appropriate period.

Practitioner's view: Excerpt from an interview with Ms Jane Bridge

Further to the review of the ASX 300 and disclosure on board evaluation set out in Figure 1 of ASX 100, the following interview with Ms Jane Bridge, Partner at Boardroom Partners and the leading practitioner in the field of board assessments, brings out further insights on the topic from the perspective of someone who has conducted numerous evaluations across many boards of directors.

Q: In contrasting board dynamics and assessments from the 1990s to today, what is the single standout paradigm shift you have observed?

A: If I reflect on the approach at Boardroom Partners over 16 years, then of course, it has evolved — we have more experience; the appetite and sophistication of boards for review has increased. Today, many boards appreciate that the 'tick and flick' approaches of the 1990s did not produce earth-shattering results, but did, at least put review on the agenda.

With the ASX Corporate Governance Council now recommending regular reviews for boards, committees and directors of listed companies, the practice is much more widespread; in listed companies, obviously, but in private companies, government boards, the charity sector and others. This has brought with it greater awareness of the potential value, as well as a 'ho-hum' element with some boards who quite understandably believe that there must be more to this than yet another survey. Most boards are more discerning; many have very clear objectives for a review and high expectations about the value that can be delivered'.

The move to individualised approaches for boards is one step change, as is the focus on dynamics and interactions, rather than checking the existence of a policy document or some other administrative detail.

Q: Have changes in the company secretary role since the 1990s improved the dynamic of undertaking board assessments?

A: Given that reviews can separately assess the board, the committees and the individual directors, there is a significant role for the company secretary to ensure that each of these parts is well co-ordinated and aligns as a whole in the final result.

For us, the company secretary has a critical 'liaison' role in many reviews: they will be the source for documents once a review is underway and they can provide valuable insight into the operations and working of the board'.

Pitfalls vs benefits of who is reviewed

Taking a practical tack while being systematic is a fine balancing act to board and director evaluations; this is a far cry to the way things were done in the past. There must be a fit between the objectives for the review and the method employed for the board evaluations. Without that fit evaluations will not meet their purpose: agents, participants, and the substance of the mode of the evaluation must all mesh nicely together. Incorrectly undertaken board and director evaluations may lead to distrust among board members and the board and management. Boards start by considering the overriding motivation for the evaluation process and then consider factors as set out in the Table 1.

It is imperative for the evaluation process to examine a wide range of potential causes or influences on the objective of the evaluation. Typically the issues the board wishes to evaluate include a performance problem, board size, the stage of organisation finds itself in the business life cycle and major developments in the competitive environment or to identify any skills gaps on the board.

Table 1: Factors to consider in board evaluation

Setting objectives • delegated to a small group or the board (that is, the governance committee or nomination committee) or • an individual (chair or lead independent director). Consulting with an external adviser to overcome board 'blind spots'/ biases is ideal.	**Who will be evaluated?** Cost or time constraints often preclude a wide-ranging review of the performance of: • the board as whole (including committees) • individual directors (including the roles of chair and/or lead independent director) • the CEO and company secretary.
Group vs individual There is the potential to create serious conflict within the board if individual performance evaluation is introduced when some directors are opposed to the process. Consensus must be reached before introducing the process.	**What will be evaluated?** The majority of governance concerns are the result of the interplay between individual skills, experience and motivations; the relationships between the board and management; and the effectiveness of supporting governance policies, procedures and processes.

Board evaluations feed the skills matrix

'Recommendation 2.2: A listed entity should have and disclose a board skills matrix setting out the mix of skills and diversity that the board currently has or is looking to achieve in its membership' of the Principles and Recommendation has proved to be a contentious and hotly debated requirement.

An ideal board evaluation framework can be used to address the skills of the board as a particular evaluation objective. When there have been major changes in the strategy or competitive environment of an organisation, the board will review its skill set to address the changes in the environment. Considering what to evaluate for 'skills gaps' depends on the size of the board, its structure, and how it undertakes the functions of risk management strategy formulation, and monitoring of management; these are critical. At that point the board need to also turn its mind to how the gaps will be resolved; this is an involved and detailed process beyond the scope of this article.

Company secretaries' view: Excerpt from interviews with two early adopters

There were only 68 early adopters of the third edition and so not a large range of skills matrices to review at this stage. Two of those can be compared as each took a different approach. Worley Parsons has taken a direct enumeration of specific skills clearly aligned to corporate strategy, noting how many directors held particular skills and experience, but not allocating any of those to individual directors. While Telstra has in contrast developed a holistic matrix, in which the company did not allocate particular skills to particular parts of the strategy or allocate particular skills to individual directors. In my opinion investors will appreciate the Worley Parsons matrix more than the Telstra approach, as I believe it provides a clearer 'investment narrative'. Another example is Perpetual, which has taken a percentages approach. This is clear and concise but in my view does not readily align or address 'strategy'.

The following are excerpts from two early adopter company secretaries: Mr Peter Janu of WorleyParsons and Ms Joanne Hawkins of Perpetual.

Q: What tips would you give to other company secretaries involved in developing a skills matrix?

A: Peter Janu: Send questionnaires to directors concerning their assessment of whether they have the relevant attributes so that you have relevant data before you start to develop the matrix. Get a designer involved in how you can graphically display the data so you can assess options and what 'works'.

A: Joanne Hawkins: We maintain a matrix of desired skills for board recruitment and succession planning purposes. We then use that as a base for the matrix reflecting the skills directors currently bring to the board.

Q: What influences came to bear in its development, such as, academic material, examples from other jurisdictions or Australian examples?

A: Peter Janu: Nil. We looked at disclosures of other companies around the world.

A: Joanne Hawkins: We looked at both Australian and international examples to build ours.

Australian framework

Typically boards need to consider their specific objectives in light of a corporate governance framework, which in Australia is the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*. The Principles and Recommendations provide a framework the board can utilise to develop topics and/or questions for their board evaluation process. For example, 'Principle 2: Structure the board to add value' could form the core benchmark for the evaluation of a board, that is, does it have the proper structure, skills and experience represented on the board? Is the size of the board adequate for it to discharge its duties and responsibilities? What are those responsibilities and duties? Disclosure of the process is also very much required at Recommendation 1.6 (a) 'disclose a process for periodically evaluating the performance of the board...' and (b) 'whether a performance evaluation was undertaken.'[7]

New framework: Teamwork

Concentrating on the team dynamics rather than individual performance is a way forward in board evaluations. While boards operate in different competitive environments with differing ranges of performance issues impacting the key decisions required of them; what is pertinent to all boards in implementing an evaluation process is a consistency in the approach.[8] While there is research evidence suggesting that directors find individual director evaluation a beneficial process and quite commonly undertaken; alternatively and — based on deeper research more effective means — focuses on the 'board-as-a-whole' not the assessment of individual directors. Evaluating the 'board as a whole' regularly helps directors mature toward a shared understanding of their role and responsibilities in corporate governance.

I am very keen on external board assessment based on the team concept. I am absolutely against assessments of the old genre which potentially pitted one director against another…

Extensive research into multidisciplinary teams in a variety of contexts found the greater the diversity of expertise, in terms of the relationship with team 'learning' and team performance, under varying levels of stressors found that teams with low expertise diversity was negatively related to team learning and performance. Expertise diversity promotes team performance.[9] The challenge is to gain greater diversity on boards while continuing to evaluate the performance of current board teams.

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Notes

1 Sonnenfeld J A, 2002, 'What makes great boards great', *Harvard Business Review*, Vol 80, No 9, pp 106–113. This is a much cited quote, for example recently in Kellermann A J, de Haan J and de Vries F, 2013, *Financial Supervision in the 21st Century*, Springer — Verlag Berlin Heidelberg, Ch 8 'Board Evaluations', p 121.

2 Ibid

3 Due to space constraints and the unique issues within that sector I will not address the NFP or the impact of social media on corporate boards and their motivation to greater assessment in this article. I also acknowledge that Australian corporate governance practices, such as board assessments, do not occur in a vacuum. There is a significant influence on Australia from other jurisdictions such as the UK, USA and Canada and a comparative analysis is worth undertaking in a separate article.

4 Dalton D R, Daily C M, Ellstrand A E and Johnson J L, 1998, 'Meta-analytic reviews of board composition, leadership structure, and financial performance', *Strategic Management Journal*, 19(3), pp 269–290.

5 Schmidt S L and Brauer M, 2006, 'Strategic Governance: How to assess board effectiveness in guiding strategy execution', *Corporate Governance: An International Review*, Vol 14, Issue 1, pp 13–22.

6 Dalton D R, Daily C M, Johnson J L and Ellstrand A E, 1999, 'Number of directors and financial performance: A meta-analysis', *Academy of Management Journal*, 42(6), 674–686.

7 ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*, 2014, p 13.

8 Minichilli A, Gabrielsson J and Huse M, 2007, 'Board evaluations: making a fit between the purpose and the system', *Corporate Governance: An International Review*, Vol. 15, pp 609–622.

9 Van Der Vegt and Bunderson, 2005, 'Learning and performance in multidisciplinary teams: the importance of collective team identification, *Academy of Management Journal*, Vol. 48, No 3, June 1, pp 532–547.