

A Study of Board Dynamics-Evaluation Models for Board of Directors - An Academic Perspective

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Abstract

Ever since the era of reforms, corporate governance regulations and practices have gathered momentum. The reformed clause 49 and the company law bill 2008 consistently focus on the board of directors as an integral internal mechanism to monitor corporations. Businesses have realised that the long term sustainability can only be achieved by evolving good governance practices in all the facets of operation.

The board of directors are considered to be the fulcrum of corporate governance. The governance of any corporation depends on the intent and inclination of the boards. This paper makes an inquiry into the practices of board evaluation prevalent across nations, and corporations. It is not just the intent and inclination that brings effective monitoring of the managers, but the openness of the board to be evaluated and scrutinised by the stakeholders pave the path for improvement, and amendment in practices that facilitate the organisations to be steered towards its mission and objectives.

The study is undertaken to orient researchers and practitioners in India on various board evaluation techniques and models prevalent across nations that can be emulated to enhance productivity and performance of the board of directors leading to good governance.

Keywords: board of directors, evaluation techniques, legal framework.

1. Introduction

The board of directors is considered to be the fulcrum of corporate governance; an important governance device increasingly being held accountable for the organisations they govern.

The critical nexus that decides the fortunes of companies' They are often referred to as the DNA of the company. The responsibilities of the board comprise of internal leadership and guidance of the corporate entity, and wider external responsibilities towards the varied stakeholders who are partners of the business entity. In the process of fulfilling these responsibilities the boards are expected to maintain balance between strategy and accountability, encouraging performance while simultaneously maintaining effective control. Demb and Neubauer (1992a:16) argue that there is too much focus on the role of board that equates corporate governance with the role of boards. Other authors indicate that corporate boards are important to the accountability of corporations and the way corporations comply with modern ethical and economic standards. Despite the variations in the descriptions, the importance of the role of the board on corporate governance is undisputed. Cadbury (1993:9) states that it “. . . is the ability of boards of directors to combine leadership with control and effectiveness with accountability that will primarily determine how well . . . companies meet society's expectations of them.” Williams and Shapiro (1979) see strong and effective boards as valuable corporate assets. However, both management and directors also share another, more fundamental, goal – to

develop a board which can bring the best, most informed and most objective advice available . . .” (Williams and Shapiro, 1979:14-15). Wang and Dewhirst (1992) even proclaim that the board of directors is one of the greatest organizational innovations in the field of corporate governance. The one element that is absolutely essential in the armoury of directors and boards is judgement :legally the board is the highest authority in the company ,”the fountain of power “yet the top management naturally tends to exercise that power...board members are expected to provide critical judgement on management performance –which requires an in-depth knowledge of ,and intimacy with the affairs of the corporation-and at the same time to assure that this judgement is independent-which requires distance and detachment. Demb and Neuberger (1992;13-16)

Make up of good boards:

The vital Characteristics

Leaders are integral to good teams so also the board performance depends on board leadership and the team of directors at work. Sound boards are led by sound leaders. Good leaders create successful teams. It is often said “outside directors never know enough about the business to be useful and inside directors always too much to be independent’. Good boards avoid this claim with all directors both executive and non-executive forming a cohesive team in which independent, tough minded individuals work together with trust and mutual understanding to achieve common goals of the organisation. The boards of both winner and loser companies appear to attract articulate and highly paid people. However, the two groups distinguish themselves particularly in their respective approaches to managing change, leading transformation and creating future opportunities (Coulson-Thomas, 2002b)

Poor boards are characterised by weak leadership, low commitment from the team members, lack of interest from the outsiders, arrogant and dominating leaders, weak willed and easily lead team, and finally incompetent members.

Perspectives on role of boards

The premise that corporate boards are important mechanisms to improve the performance and competitiveness of corporations is receiving support from an increasing number of competing practical and theoretical perspectives on corporate governance. As one of the leading theoretical approaches, the agency theory is frequently applied to understand the role of corporate boards to mitigate agency problems boards are seen as devices that alleviate agency problems associated with modern corporations Berle and Means'(1932) classical dilemma of the separation of ownership from control in listed Corporations

Another leading theory, the resource dependence theory, emphasizes the resource allocation role of corporate boards. The involvement of directors in the strategic course of the corporation is mainly understood in the relatively new stewardship theory. Distinctive perspectives of corporate governance - such as the shareholder and stakeholder perspectives - give rise to differences in the definition of boards’ roles in the governance of corporations. Seen from a shareholder perspective of corporate governance, corporate boards are understood as internal devices to align the interests of management and shareholders. The stakeholder perspective of corporate governance sees Corporations as super ordinate entities in which a variety of parties have vested legitimate interests. As such, this perspective also recognizes interests of stakeholders other than stockholders that need to be protected by corporate boards of directors. This also has implications for the roles of corporate boards in the governance of corporations. As stated by Gedajlovic (1993:53): “The executive (and non-executive directors, executive directors.) must balance the pluralistic claims of those with a vested interest in the corporation in order to secure their required contribution.” The roles of corporate boards may ultimately depend on specific circumstances and the way stakeholders and directors themselves define the responsibilities of boards of directors and those of affiliated corporations. “Corporate performance would

appear to depend primarily upon what boards actually do and how their members behave rather than formal governance considerations such as a board’s committee structure’

Board styles:

There is a significant difference in the board styles across nations and across corporate entities The board style adopted depends upon several factors internal and external to the organisation. It is a function of many variables the preliminary being the board leadership and the role assumed by the chairman. The factors having a direct impact on the on the style adopted are as follows:

1. The size of the board: Too many members on the board restrict the opportunity of an individual member to contribute, and the board may be divided into factions.
2. The balance between executive and non-executive directors: This would directly impact the tenor of deliberations in the board room
- 3The attributes of directors: This would directly have a bearing on the proceedings and outcomes of the deliberations. The knowledge base, the experience, the skills etc are highly contributory factors to the performance of the board.

The incidental factors influencing styles adopted by the board could be enumerated as under:

- Traditions of the corporate entity influences the style of functioning of the Board,
- Corporate vision outlined by the senior management,
- Innovation expected,
- Desire for degree of control,
- Degree of commitment that is received from the members of the board,
- Adaptability of the board members,
- Willingness to collaboration,
- The extent of conflict among the members,
- Ease and clarity of communication among the members of the board
- The element and degree of trust in the board determines the style adopted.

Based on the resultant outcome and objectives determined by the board the board functioning styles can be presented into a simple matrix, contrasting the concern for relations between members with its concern for getting the job done.

Fig. 1.1 BOARD STYLES EVALUATION MATRIX

<i>Concern for board</i>	High	Country club board	Professional board
	Low	Rubber stamp board	Representative board
		Low	High

Concern for board performance

Some of these characteristics of the board style reflect the importance given to relationships at board level and the way the board members work together. Others styles focus on the performance compromising on relations. Neither of the extremes are appreciated for their styles. The challenge for every well-functioning board would be to balance concern for relationships with concern for achieving better performance. Firms scoring well on both relationships and tasks can be considered to have a professional style. Those scoring low on each count are rubber stamp boards which can appropriate in subsidiary companies that are managed through a group management structure. Performing high on relationships and with low concern for task are

the country club boards. This evaluation matrix of board style can effectively be used for board performance assessment to evaluate the styles in practice.

BOARD EVALUATION:

Corporate performance depends primarily on what boards actually do and how their members behave. Winning boards are distinguished by the attitudes and conduct of their members and the approaches they adopt. Board evaluation is a powerful tool to lift performance. Corporate boards and directors in well developed markets are being increasingly judged by their societal peers and investing public. Board evaluation serves as the tool for checking the progress against the envisioned plans. It is imperative for the board to hold itself to the same standards it holds for all other areas of business operations. Corporate governance, a mindset that embraces performance evaluation is also likely to be oriented to achieving best practice in all the roles and functions of the Board. A Board that doesn't know how it is performing is unlikely to be adding value to the organisation it governs and which is paying for it to exist. It may well be wasting the time and effort of the Directors and of all those who are tasked with supporting them. In some cases, wastage of time and the squandering of money may well be substantial, and will probably be hidden from those involved.

Board evaluations are being encouraged by various stakeholder forums and there is a clear mandate presumably to maximise board performance and minimise risk. The interest in evaluations is also heightened as a result of increasing board autonomy and corresponding increase in business complexities.

Why the increased interest in board evaluation?

1. Increasing expectations on accountability by the cross section of stakeholders:
 - members/stockholders
 - government agencies
 - Public in general is interested in business.
2. Stricter enforcement of laws after the collapse of governance systems.
3. More lawsuits against boards of directors.
4. Great consequences for mistakes made by the board.

Frequency of Evaluation

Formal board performance evaluation should occur every second year. Other situations where it may be appropriate to conduct a board evaluation include:

- Change of the chairperson;
- Change of the organisation's role;
- Breakdown of decision-making processes; and
- Emergence of a dysfunctional board dynamic.
- `Board evaluations may be linked with a skills audit for the board,
- On the development of succession Planning.

Methods of Evaluation

Many evaluation approaches exist. Specifically, board performance can be evaluated through:

- Informal discussions around the boardroom,
- Confidential one-on-one conversations with the chairperson,
- Facilitated discussions on specific governance issues and trends,
- Surveys, and
- Interviews.

Sometimes the assistance of an external evaluator may be warranted. External evaluators offer an independent perspective and an opportunity to inject new ideas and reference board practices against emerging best practice. They can also remove the chairperson from the (at times uncomfortable) role of soliciting feedback on performance issues (including their own performance as chairperson) and permit the chairperson to have an active role as contributor to the review.

Selecting the Evaluation Method

Whatever the approach selected to evaluate the performance of the board there should be consideration given to the following:

- Board Members previous experience with evaluations;
- Nature and severity of the issues facing the board;
- Requirements to disclose results of an evaluation; and
- Requirements to impose external standards.

Expected and Desirable Outcomes

Evaluation as a process would be meaningless unless they ensure the following:

- Evaluation solicits honest, genuine and constructive feedback,
- Identify and address the real opportunities for improving the performance of the board,
- Prepare a manageable number of recommendations with a clear process for implementation,
- Enhance the performance and effectiveness of the board decisions.

Facets to be considered while reviewing and evaluating Board Performance

Evaluating the work of the board can be done by an external facilitator or by each director using a standard questionnaire. In addition to illustrating areas in which the board excels and suggesting plans for improvement, specific elements that can be assessed include:

- The board's mission, goals, and bylaws;
- The board members' understanding of their roles and duties;
- The quality of job descriptions and the members' commitment to the board;
- The board's use of its committees and the quality of the committees' terms of reference;
- Board members' understanding of their fiduciary duties;
- The diversity of the board's composition
- The board's ability to accurately represent its stakeholders;
- The quality of the relationships between board members, as well as between the board and the organization;
- The quality of the communication between the board and the organization;
- The board's policies;
- The efficiency of the board meetings, decision-making processes, and board member participation;
- The quality of the board's written work plan;
- The board's ability to address conflict effectively and openly; and
- The board's use of resources.

The board should have the results of the assessments summarized and distributed to each member appraisal.

Tangible & intangible benefits of evaluation:

Most of the benefits accruing from the performance evaluation can be summarised as under:

- Provides the board with a chance to reflect on and assess its areas of strength and weakness. Toning of the board, in terms of its constituents and optimally benefitting from the skills and expertise

available to the company. These evaluations may indicate gaps in the availability of specific skills or knowledge which the board may then begin to remedy through further additions or by more focused application by its members.

- Provides the board with an invaluable yardstick by which it can prioritize its activities for the future. Deciding the training inputs and other initiatives where the board and the individual directors concur. This will help in improving the capability of the board.
- A formal appraisal encourages all directors to reflect on what the board has accomplished, as well as on what it should be doing in the future. In deciding the remuneration of directors, particularly of the non-executive category. While many company boards follow the easy route of rewarding all the directors equally, such a practice may not be conducive to appropriate motivation of members whose contribution and commitment may be of a higher order. Performance appraisals by peer could well be the best way to determine differential remuneration to the directors.
- Can serve an educational and consensus-building function -- by clarifying and defining the overall standards of performance for the board. Such appraisals will facilitate the recommendation of directors for reappointment at the end of their term. Those with consistently poor performance during their tenure may be easily identified and eased out without much embarrassment. Such a review can optimally result in all directors contributing to setting goals of the board. Contributing directors could be motivated to continue and better their personal performance when they realise that their work is receiving peer recognition. Often this could be a stronger motivator than mere monetary rewards. An evaluation which points up strengths as well as weaknesses can give a board a sense of its own competence and accomplishment as a group.
- Evaluation is sound foundation on which positive changes can be initiated.

PRACTICES ON BOARD EVALUATION: FEW INDIAN EXAMPLES

Board evaluation practices prevalent in Indian companies: (as stated in the annual reports)

1. **Oil & Natural Gas Corp.** India's biggest energy explorer plans to evaluate the performance of independent directors, amid concerns raised by a former chairman of the company that there may be board members who do not even read the agenda of a meeting. ONGC's board will scrutinise the performance of eminent personalities who have been appointed independent directors. (August 28, 2012 Economic times)
2. **Infosys Technologies Ltd:** Mechanism for evaluating non-executive board members. The board evaluates the performance of non-executive / independent directors through a peer evaluation process every year. Each external board member has to represent before the entire board on how they have performed / added value to us. Every board member evaluates each external board member on a scale 1 to 10 based on the performance indicators. Independent directors have three key roles, namely, governance, control and guidance. Some of the performance indicators are based on which the independent directors are evaluated are: -
 - Ability to contribute to and monitor corporate governance practices.
 - Ability to contribute by introducing international best practices to address top management issues.
 - Active participation in long term strategic planning
 - Commitment to the fulfilment of a director obligations and fiduciary responsibilities - this include participation and attendance.

3. Dabur India

Mechanism for evaluating non-executive directors. The performance evaluation of non-executive directors is done through a peer – to peer performance evaluation of the board of directors. The directors are marked on a scale of 1 to 5 with respect to three broad parameters namely – guiding strategy, monitoring management performance and development/ compensation and statutory compliance & corporate governance.

4. Tata Motors Ltd

Mechanism for evaluating non-executive board members. The performance evaluation of non-executive directors is done by the board annually based on criteria on attendance and contributions at board /committee meetings as also for the roles played other than at meetings.

5. Wipro Ltd.

Mechanism for evaluating non-executive board members. Independent board members. In line with our corporate governance guidelines, evaluation of all board members is done on an annual basis. This evaluation is led by the Chairman of the board Governance and Compensation Committee with specific focus on the performance and effective functioning of the board as a whole, committee of the board and reports the recommendations to the board. The evaluation process also considers the time spent by each of the board members, core competencies, personal characteristics, accomplishment of specific responsibilities and expertise.

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Board Performance, the board recognizes the importance of reviewing and improving upon its performance and meets regularly to discuss the effectiveness of its functioning and to agree ways in which performance can be further improved.

Challenges in evaluation of board performance:

The challenges associated with evaluations are multi fold. Personal feelings come into play, especially when the evaluations look at individual board member performance, or when a chair takes board evaluations as a measure of their personal performance. In addition, the ability to give and take constructive criticism varies among individuals, and is culturally biased. Irrespective of cultural issues, public shaming is almost always counterproductive. It is important to focus on being constructive, and on how to improve performance versus focusing on whom to blame. Another issue is the objectivity of evaluations. An abundance of checklists and scorecards exist to address this concern. But, while checklists against hard and measureable criteria may be more objective, they generally fail to measure qualitative factors and the more important human element. For example, the ability to work as a team is notoriously difficult to assess quantitatively. Ultimately, a combination of hard and soft analysis is best. The role of the chair in performance evaluations is also a concern. Clearly the “imperial” CEO/chair may not be best suited to exercise leadership of a board evaluation process. The likelihood of an unbiased evaluation seems limited. Furthermore, chairs can use performance evaluations to get their personal views or messages across, and even intimidate or otherwise influence team members. Performance evaluation loses all credibility and usefulness if it is not scrupulously fair. The solution may be to conduct performance evaluations with the encouragement of the chair but to assign the task of evaluation to an independent board member or an outside consultant. External advisors can greatly assist in addressing all of these challenges. External services are widely available, and are typically well-versed in board issues and have the technical tools to provide a solid analysis and good feedback. External advisors may also be an excellent source of knowledge on best practice. Of course, external advisors are not perfect and need to be selected with care.

Conclusion:

Board evaluation is becoming a mandatory requirement, and with the move towards comprehensive evaluation practices now being followed by global corporations it is imperative that Indian boards also start thinking seriously of the various models for appraising and evaluating their boards performance. In conclusion we may assert that, performance evaluations are useful when they are formal, well-designed, fair, and Iterative linked to improvement plans. They are also enhanced when there is some element of feedback on elements of external accountability. Finally, performance evaluations can be used as a means of identifying skills gaps to help guide the search process for new board members.

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