Chapter 17

Can Boards Learn?

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Some years ago I was working with executive development in a large pharmaceutical company. The HR staff there often said—to one another—that line managers apparently ceased to need development the moment they reached the level of Senior Vice President**.** At least it was extremely difficult to tempt them with any kind of development activities besides attending Harvard Business School conferences and other high-status activities.

If that were universally true, then one would assume that directors would have even less development interest. I mean, a board member is even higher on the ladder than any Senior Vice President and has doubtless regarded the development process as complete for a long time. Someone who felt so near to perfection would see no further need for development, one would assume.

This is, however, not the case. My experience with boards in Scandinavia over the last couple of years indicates that directors' willingness to develop their own skills and competencies further is still intact However, their ways of doing so may take other routes than individual development plans, courses, and workshop sessions.

My point of entry in stating this case is corporate governance. The recent debate on the topic in the wake of various company scandals has opened a new platform for top-level executive development, where the performance of the board is in focus.

The Scandinavian corporate governance model differs slightly from the Anglo-American one. A distinct feature in Scandinavian boards is that directors very seldom also have an executive role in the same company. Being a CEO of the company and at the same time chairing its board is in fact forbidden by law. This creates a kind of split model where two distinct subsets—the supervisory board and the executive board, with no membership overlap—have to find ways of cooperating with one another. The following experiences reflect that model, but in the Anglo-American setup one could in a similar way look at how executive board members (everyday management) operate vis-à-vis supervisory board members (independent members) although enrolled in the same overarching structure.

Self-Assessment as a Natural Part of Good Management Practice

In the June 2003 issue of the magazine *CFO-Europe* the question of corporate governance was elevated to become "theme of the year." The magazine's feature article contained a description of the various actions different European companies have taken in connection with corporate governance. One of the companies highlighted was the Denmark-based Novozymes A/S, where—among other activities—a systematic evaluation of the cooperation between the Board of Directors and the Management Board at that time had taken place for two years. Presently it has been done for three consecutive years, facilitated by the author of this chapter.

> Reporting on governance at Novozymes is a "work in progress" . . . But for the time being, Novozymes is "as good as it gets in Europe" in terms of transparency on governance structures.[1]

Investors also seem increasingly interested in the principles of corporate governance. This indicates an increasing demand for professionalism and efficiency in the work in the board of directors. In addition, one of the criteria to qualify for the Danish Corporate Governance Award

2003, issued by the Association of Shareholders in Denmark, was that self-assessment of the work of the board was taking place.

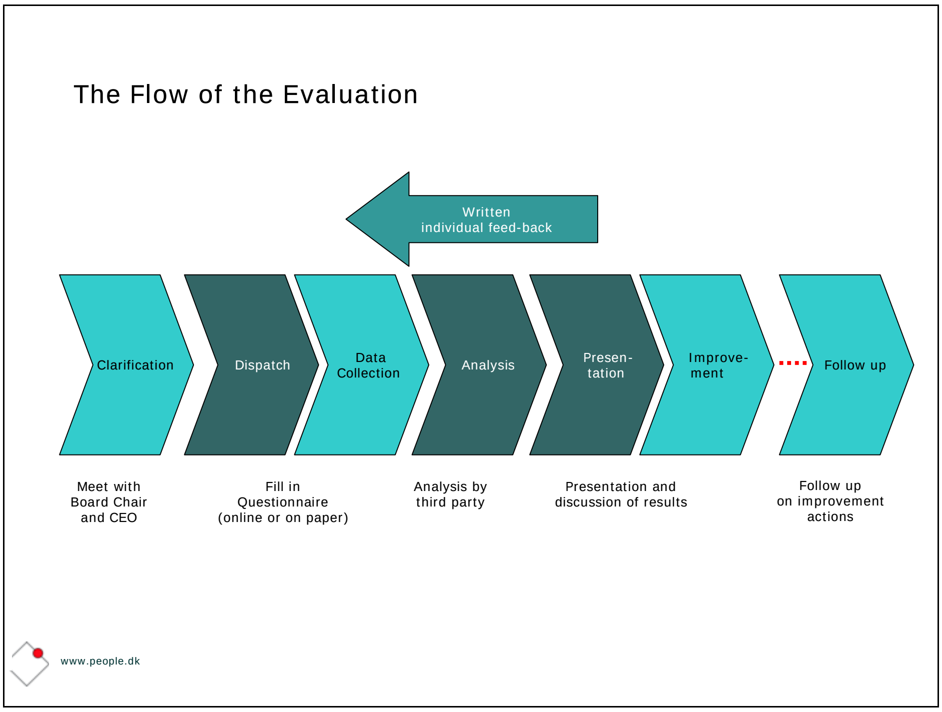
A number of companies have already incorporated the recommendation to evaluate the board and have established some kind of system for internal evaluation of the board of directors. Very few have taken the process to its logical conclusion and included the board of directors' evaluation of the management board and vice versa. By systematically incorporating all aspects of the cooperation, a fruitful debate regarding roles and expectations may be opened. This will strengthen the overall company management.

Evaluating the Cooperation Between the Board of Directors and the Management Board

It is beneficial to combine evaluation of the way the board of directors works, of the cooperation between the management board and the board of directors, and of the individuals' contribution into one process. This is especially the case if the process is facilitated by a neutral third party. This external resource is in a position to transmit the analysis and results in a nonpersonalized and constructive manner.

My own experience with this type of work is based on the process reflected in Figure 17.1. The parts that involve the board of directors are light blue , while the steps handled by a third party are darker toned.

Figure 17.1: Board Evaluation Process



This process has proven to be well suited to the board environment and after a few adjustments it has become simple to handle. However, demand for other types of approach is emerging—especially since more boards are looking for ways to handle the process themselves, if they have the time and energy. In this case, the third party plays neither an active nor a facilitating part, it merely processes the data and designs the analysis for the boards' exclusive debates. It is easy to imagine that under certain circumstances it would be more appealing to a board *not* to have an outsider as an active player. Nonetheless, such a board would still value impartial and professional handling of the data and results before the final discussion of possible improvement areas takes place behind closed doors.

The first clarifying phase is a discussion between the board Chair, the CEO, and the third party. The aim is to establish exactly the areas to be evaluated as well as to clarify the logistics of the review. As a minimum, the legislative responsibilities of the board of directors should be addressed in the evaluation. These may vary slightly from country to country. In Denmark a board is specifically required to

- Supervise the company's **operation and economy.**
- Approve and follow up on the company's **strategies.**
- Ensure **appropriate organization and management** of the company.

In addition, the evaluations have so far included a section focused on the general cooperation between the board of directors and the management board. Furthermore, a special section has been designed to provide feedback to each individual member from all the others. In this section all the board members have had the opportunity to assess and comment on their own and their fellow members' individual contributions regarding selected issues. Each member has also had the opportunity to express expectations regarding the future contributions from each of the others. Experience here shows that a few boards feel that the individual feedback is a big step to take the first time. Instead these boards choose the general elements as the basis for the first evaluation, but might decide to supplement with the individual feedback element the following year, when more familiarity with the process has been established.

At the choice of the individual, the evaluation form can either be filled in electronically or on paper. This is to ensure that everyone involved feels comfortable with the process—some board members still cling to good old pen and paper. Furthermore, it is important to verify that all members have the time and opportunity to participate within the agreed-upon time frame. Normally twenty to twenty-five minutes should be set aside to fill out the questionnaire, especially since what really adds value to the analysis and the subsequent debate is the narrative commentary on the questions. An example of a possible form structure is illustrated in Figure 17.2.

1. FINANCE AND OPERATION

Executive Management's contribution to finance and operation	Poor	Inadequate	Good	Excellent
Quality of materials sent to the Board prior to meetings	☐ ☐ ☐	☐ ☐ ☐	☒ ☐ ☐	☐ ☐ ☐
Contributions to open and clarifying discussions	☐ ☐ ☐	☐ ☐ ☐	☐ ☒ ☐	☐ ☐ ☐
Sum-up that results in appropriate action	☐ ☐ ☐	☐ ☐ ☐	☒ ☐ ☐	☐ ☐ ☐
Overall evaluation of Management's contribution to finance and operation reporting	☐ ☐ ☐	☐ ☐ ☐	☐ ☒ ☐	☐ ☐ ☐

Comments to the scores, including suggested improvements:

It would be beneficial to have an agreed upon format, content, level of detail. From time to time BoD members have requests that don't go in the same direction and are not really taken up and concluded on in the BoD

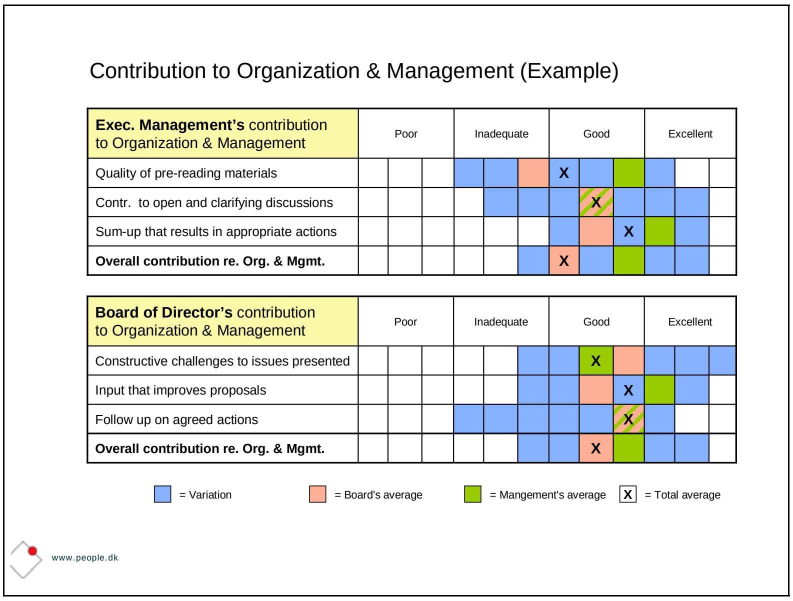
Board of Director's contribution to finance and operation	Poor	Inadequate	Good	Excellent
Constructive challenges to issues presented	☐ ☐ ☐	☐ ☐ ☐	☐ ☒ ☐	☐ ☐ ☐
Input that improve proposals and recommendations	☐ ☐ ☐	☐ ☐ ☒	☐ ☐ ☐	☐ ☐ ☐
Follow up on agreed actions	☐ ☐ ☐	☐ ☐ ☐	☐ ☒ ☐	☐ ☐ ☐
Overall evaluation of Board of Director's contribution to finance and operation reporting	☐ ☐ ☐	☐ ☐ ☐	☒ ☐ ☐	☐ ☐ ☐

Comments to the scores, including suggested improvements:

The BoD does contribute, but with a few exceptions just with common sensical comments that do not add much. The BoD could benefit from thorough briefings on the industry specific key financial drivers.

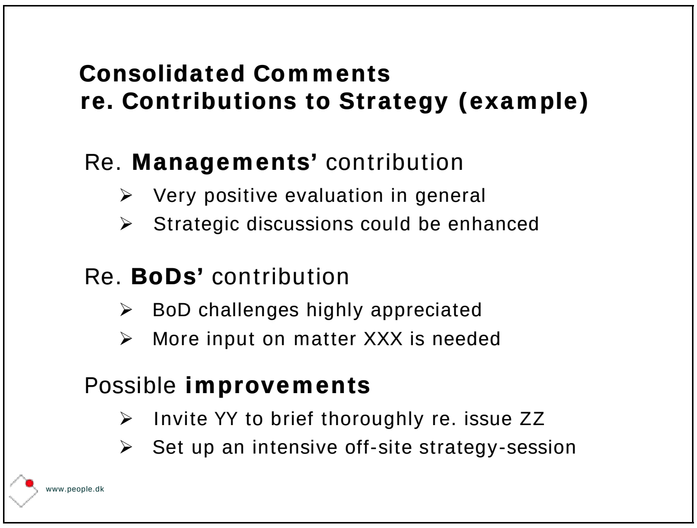
After the return of the forms, the third party analyzes them. For each question the standard deviation, the management board's mean value, the board of directors' mean value, and the overall mean value are calculated (please see Figure 17.3)

Figure 17.3: Questionnaire Results Format



This way of presenting the results has proven useful since it—without singling out individuals—allows the board members to clearly visualize any overall differences in perception between the two subsets, thereby creating a good basis for debate and a decision base for future improvements.

As indicated above the most valuable part of the data are however the narrative comments provided. From this it is possible to qualify, consolidate and substantiate possible improvement areas and actions as illustrated in Figure 17.4.



The feedback section of the form, which contains the input from the individual members, is also made anonymous when presenting the results. Here, only a general graphical overview of each question is presented. From this, it is possible to see the deviation and mean values regarding all members. At no point is the assessment of any individual disclosed at the general presentation.

The board members can also receive short individual summaries of the feedback regarding their contribution—closed envelopes containing a graphical overview of the combined assessments compared with their own personal assessments, plus a paraphrased consolidation of the comments and expectations vis-á-vis that individual. It is recommended that the chair receive a copy of these summaries for all members of the board of directors, and that the CEO (if the positions are separate) similarly receive the summaries of the members of the management board. To the extent desired the feedback part can be utilized as the basis for one-to-one discussions of contributions and expectations.

Finally, the presentation of the overall analysis will include a summary of the areas where possible improvements regarding the future cooperation might be contemplated. As a consequence, it would be natural to follow up on decisions regarding desired changes at coming board meetings, and when doing a possible new assessment the following year.

Experiences So Far

The systematic assessment process described here has demonstrated a number of clear advantages as a learning and development driver. It does, however, also raise issues that require careful consideration.

First of all, it turns out that using a third party for the assessment puts the facts systematically on the agenda—it legitimizes the idea that the board will discuss and address possible improvements in its internal operations. One Danish business professor discussed the question of annual board self-assessment in these terms:[2]

> I think it’s a good idea. But I don’t consider it sufficient to conduct the self-assessment over the coffee after dinner. It is my impression that this is handled well with the use of designed forms to be filled out. This may serve to breach internalized routines and traditions, which the boards otherwise work by. It further ensures that the boards to a high degree discuss relevant matters. It goes without saying that this should be adjusted to reflect the culture of the company in question.

My experience supports this. The process does promote a factual and professional debate about the cooperation. Most boards have experienced it to be surprisingly unintimidating when they get into it, and at the same time, they nonetheless find it a valuable exercise to focus on the patterns that characterize their cooperation and thereby highlight the improvements that should be made.

Furthermore, it has proven to bring the directors’ different expectations regarding cooperation and anticipated roles out into the open, thereby making the differences discussible. This almost always results in a positive clarification. For example, it is often useful to discuss where the board of directors’ curiosity for detail should stop, and where the management board’s independence should begin. Another useful question is how reporting could become more adequate, thereby saving valuable time at board meetings.

In addition, the evaluation process has made it possible for boards of directors to assess whether they experience holes in their supervising overview and their ability to monitor different business aspects. Conclusions on how to best minimize these holes going forward can then be made jointly with the management board. Further, valuable assessments have been made regarding special competencies that the boards might have a need to strengthen or supplement in order to meet the business challenges of the future.

The process can also be of value in highlighting and bringing up for debate the way the various board committees are handling their responsibilities and where communication lines, reporting procedures, and coordination could be improved internally.

In every case I have observed, a clear, mutual understanding of what might be improved in board operations and how this should be done has been the result of the evaluation process, including a realistic balance of effort and outcome. After the review, it has been possible to follow the progress in these actions for improvement. Likewise, the following year's evaluation has contained an assessment from each member stating whether the agreed-upon actions have had the desired effect.

Last but not least, it has become clear that the evaluation process has also been of interest to stakeholders outside the company. Shareholders and investors have expressed their acknowledgement of the effort. In connection with the recommendations regarding good corporate governance it is now possible for the board of directors to document *how* it undertakes its supervision responsibility and works systematically with continuous improvements.

A Publicized Example of the Result of the Evaluation Process

Novozymes A/S has chosen a high degree of openness about methodology and results when working with good management practice. In doing this the company has posted both the methodology and results of its evaluation on the internet (www.Novozymes.com). In the company's own words:

From the Novozymes 2002 Annual Report

> In 2002 we chose to go one step further [than to plan and publish frequency and contents of meetings] and develop a system for measuring, qualifying and documenting our work. In this evaluation the Board and Management assess themselves, each other and their co-operation. Our initial experience of this process has been good. Concrete actions to improve our work are defined, and the implementation of these actions is subsequently verified and documented.
>
> *The result of the evaluation of the co-operation between the Board and Management in 2002 showed a need for:*
>
> Sharper focus on relevant risk factors, non-conformances and news
>
> More stringent time management combined with greater "discipline" on the part of those attending and giving presentations
>
> More topics to be considered at Board meetings to give the Board a deeper understanding of the individual business and function areas
>
> Better background material to be sent to the Board on, for example, market developments, competitors and equity analysts' recommendations
>
> A more even balance in terms of time spent on the Board's main areas of responsibility

From the Novozymes 2003 Annual Report

> As an example of good corporate governance, in the 2002 Annual Report we described a new method for evaluating the effectiveness of cooperation between Novozymes'

Board of Directors and Management. As part of the Board of Directors' annual follow up work in 2003, the self-assessment process revealed a need for:

A sharper focus on non-conformances and trends than on operational and financial reporting

More in-depth reporting and testing of strategies outside the enzyme business, based on scenarios and strategic choices

Greater insight, breadth and depth in the reporting, discussion and follow up on organizational, environmental and social matters

Further clarification of the roles of the Management and employee representatives in relation to the Board of Directors

Issues for Consideration

Any evaluation of board cooperation must be an absolutely confidential process. It is pivotal that the trust between the parties is strengthened and elaborated. As a consequence great care should be put into making a loyal and joint presentation of the input received and of the result of the analysis. An evaluation of the board of directors is a piece of professional craftsmanship, and the management of it should be entrusted to individuals experienced with high-level development processes. The assignment should be consolidated rather than broken up into small parts so as to avoid the dangers of misunderstanding and error.

Also the confidentiality of the information must be carefully guarded. It should be a fundamental prerequisite that access to individual input is provided only to those who have been entrusted to do the analysis. The consolidated results must be stored securely; for example, deleted from the computer and held on a CD-ROM in a locked security cabinet. The complete evaluation results are worth keeping as they will provide valuable background information, should the board decide to repeat the process in the following years.

The individual feedback is the most sensitive part of the project. Its purpose is to help the directors each improve their individual contribution in the company's best interest—not to create a platform for disagreement and negative criticism. The third party needs to be able to sum up and paraphrase the different input in a way that promotes constructive reactions. In practice, however, the members of both boards are generally quite capable of stating their opinion in a professional manner—a fact that up till now has made it fairly easy to sum up and conclude on the individual feedback, and for individual board members to find it useful for refining their own contributions. Nonetheless, some boards might find it preferable to avoid using individual feedback the first time around, aiming to create a more positive environment for it by demonstrating the value of a general assessment of their operations

Finally, I would like to emphasize the importance of both the board of directors' and the management board's positive attitude toward carrying out this self-assessment process. Among other things, this requires that the board has had the opportunity of relating to the methodology, that is, the contents of the questions as well as the timing, before deciding to undertake an evaluation. A solid acceptance among those participating is—as in many other cases—crucial for the self-assessment process to be regarded as truly value creating.

Ongoing Improvement

It is, of course, natural to ask if all this effort really pays off? A majority are probably willing to accept that compliance with good corporate governance principles has a positive effect—in the long run and broadly viewed—on sustainable development of the company. Many with managerial and board experience would probably also agree that a dynamic cooperation including ongoing improvements is preferable to inefficient routines and time-wasting meetings. But is this also something that pays off in terms of visible financial results?

Unfortunately, I cannot give concrete examples of that. Either it is too soon to say, or my own insights into the direct financial effects are naturally limited. Nonetheless, I would point to two types of experience that in my belief would yield improved finical results as a direct consequence of the evaluation process:

- Dialogue between the board of directors and the management board can lead to clear improvements regarding financial reporting—better overview, increased focus on value-driven issues, and thereby also a more qualified decision base for both boards.
- Divergent views revealed in the evaluation process can reveal that the organization and its alignment to strategy have not been sufficiently documented. Initiatives to improve now have the aim to ensure that the organization is gradually aligned to the business strategy, with regard both to its operations and to ensuring qualified leadership capacities for planned growth.

In my opinion, these initiatives can only have positive effects on financial results. However, whether this is something that shareholders will honor on a short or medium term has yet to be seen.

Epilogue

So, it seems, boards *can* learn—and are willing to do so. And they even do it as an on-the-job development effort. What more can one ask for? Perhaps that we as executive development coaches become better in meeting our boards where they are and providing them with really value-adding tools and approaches in their continuous striving to comply with and exceed the expectations of their stakeholders.

Endnotes

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[1] *CFO-Europe*, June 2003. Cover Story: "Reporting for Duty" page 20

[2] Steen Thomsen, Professor of Corporate Governance at the Copenhagen Business School, quoted in *Berlingske Nyhedsmagasin*, the leading Danish financial monthly, November 17, 2003.