

REVIEWING YOUR BOARD:
A GUIDE TO BOARD AND
DIRECTOR EVALUATION

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AUSTRALIAN INSTITUTE
of COMPANY DIRECTORS

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Contents

Acknowledgements	xiii
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Preface	xv
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Chapter 1 Overview	1
1.1 Framework for a board evaluation	3
1.1.1 What are our objectives?	4
1.1.2 Who will be evaluated?	6
1.1.3 What will be evaluated?	7
1.1.4 Who will be asked?	7
1.1.5 What techniques will be used?	7
1.1.6 Who will do the evaluation?	9
1.1.7 What will we do with the results?	9
1.2 Conclusion	10

Chapter 2 Why conduct a board evaluation?	11
2.1 Introduction	11
2.2 Advantages of board evaluation	14
2.3 Barriers to board evaluations	20
2.3.1 Proven track record	21
2.3.2 Undermining board dynamics	22
2.3.3 Shareholder feedback is enough	24
2.3.4 Objective evaluation criteria	25
2.3.5 A victory of form over substance	26
2.3.6 Time commitment	27
2.3.7 Director liability	27
2.3.8 Governance is not important	29
2.4 Conclusion	30

Chapter 3	Setting objectives	31
3.1	What are our objectives?	32
3.2	Primary motivation	34
3.3	Focus of the review	35
3.3.1	Traditional board reviews	36
3.3.2	Skills analysis	40
3.3.3	Maturity assessment	41
3.4	Combining primary motivation and focus	43
3.5	Complexity	44
3.6	Scope	44
3.7	Combining complexity and scope	44
3.8	Getting started	45
3.9	First time evaluations	48
3.10	Conclusion	49
Chapter 4	Who will be evaluated?	51
4.1	Deciding who to evaluate	52
4.1.1	Stage 1: Whose performance will affect the objectives?	53
4.1.2	Stage 2: Understanding the benefits of reviewing each group	54
4.1.3	Stage 3: Estimating the evaluation costs	54
4.1.4	Stage 4: Balancing benefits and costs to reach a decision	54
4.2	Board as a whole	54
4.3	Board committees	56
4.4	Individual directors	58
4.5	Chair	61
4.6	Committee chairs	64
4.7	Lead independent director	65
4.8	Company secretary	65

4.9	CEO	67
4.10	Other senior executives	67
4.11	Conclusion	67
<hr/>		
Chapter 5	What will be evaluated?	69
5.1	Corporate governance frameworks	70
5.2	Refining the evaluation's objectives	72
5.3	The Corporate Governance Practice Framework	73
5.3.1	Defining governance roles	74
5.3.2	Key board functions	76
5.3.3	Improving board processes	81
5.3.4	Board effectiveness	82
5.3.5	Board behavioural dynamics	83
5.4	Applying the framework	84
5.4.1	Board processes	85
5.4.2	Director skills, role performance and motivation	88
5.4.3	External relationships	88
5.4.4	Dealing with dysfunction in the boardroom	91
5.5	Other frameworks	93
5.5.1	ASX Principles	93
5.5.2	APRA's Prudential Standard CPS 510 Governance	95
5.5.3	The Australian Charities and Not-for-profits Commission's Governance Standards	95
5.5.4	Standards Australia's <i>Good Governance Principles</i>	96
5.5.5	Australian Institute of Company Directors' (AICD) Corporate Governance Framework	98
5.5.6	AICD's <i>Good Governance Principles and Guidance for NFP Organisations</i>	98
5.6	Conclusion	98

Chapter 6 Who will be asked?	101
6.1 Potential sources of information	102
6.1.1 Board members	106
6.1.2 CEO	106
6.1.3 Company secretary	107
6.1.4 Senior management team and other employees	108
6.1.5 Owners/members	108
6.1.6 Customers	109
6.1.7 Government	109
6.1.8 Suppliers – general	110
6.1.9 Suppliers – external auditor	110
6.1.10 Corporate governance experts	111
6.1.11 Other stakeholders	112
6.2 Determining who to ask	112
6.2.1 Who has the knowledge?	112
6.2.2 How familiar is the board with the evaluation process?	116
6.2.3 Are the necessary resources available?	116
6.3 Conclusion	117
Chapter 7 Evaluation techniques	119
7.1 A research methods primer	120
7.2 Qualitative analysis	122
7.2.1 Interviews	123
7.2.2 Observation	137
7.2.3 Document analysis	140
7.2.4 Summary of qualitative techniques	144
7.3 Quantitative analysis: the survey	144
7.3.1 Stage 1: Decide the survey objectives	146
7.3.2 Stage 2: Decide who will be asked	146
7.3.3 Stage 3: Decide the format of question delivery	147

7.3.4	Stage 4: Design the questionnaire	147
7.3.5	Stage 5: Administering the questionnaire	158
7.3.6	Stage 6: Coding and analysing the data	159
7.3.7	Stage 7: Presenting the results	160
7.4	Conclusion	161
Chapter 8 Evaluation techniques—other approaches		163
8.1	Board skills assessment	163
8.2	In-boardroom review	175
8.3	Board meeting evaluation	177
8.4	Maturity assessment	181
8.5	Conclusion	186
Chapter 9 Who will do the evaluation?		189
9.1	Internal reviews	190
9.1.1	Chair	192
9.1.2	Non-executive director	193
9.1.3	Committees	194
9.2	External reviews	195
9.2.1	Transparency	195
9.2.2	Capability	196
9.2.3	Special circumstances for external reviews	197
9.2.4	Specialist consultant or general adviser?	198
9.3	Choosing the facilitator	199
9.3.1	Internal or external facilitator?	200
9.3.2	A final checklist	200
Chapter 10 Communicating the results		201
10.1	Who will be advised?	202
10.1.1	Internal stakeholders	203
10.1.2	External stakeholders	206

10.2	How and about what will they be informed?	206
10.2.1	Internal stakeholders	207
10.2.2	External stakeholders	210
10.2.3	Specific issues in disclosing information	217
10.3	Conclusion	219
Chapter 11 Implementation		221
11.1	The implementation process	221
11.1.1	Stage 1: Defining objectives and process	222
11.1.2	Stage 2: Data gathering and analysis	222
11.1.3	Stage 3: Discussing and agreeing upon concerns and actions	223
11.1.4	Stage 4: Following-up on implementation	226
11.2	The performance evaluation cycle	228
11.2.1	The ‘as needs’ review	229
11.2.2	The two or three-yearly review	229
11.2.3	The annual or semi-annual review	230
11.2.4	The regular meeting review	231
11.3	Persuading the board to implement regular evaluation	231
11.3.1	Establishing the need	231
11.3.2	Establishing a sense of urgency	232
11.3.3	Building a coalition	232
11.3.4	Timing	233
11.3.5	Planning a process	233
11.3.6	Reinforcing wins	234
11.4	Planning—the key to successful implementation	234
Chapter 12 Conclusion		235
12.1	The board evaluation framework	236
12.2	The future for board evaluations	237

Appendix 1 Board-as-a-whole evaluation questionnaire	239
Instruction sheet	239
Appendix 2 Chair evaluation questionnaire	247
Instruction sheet	247
Appendix 3 Committee evaluation questionnaire	251
Instruction sheet	251
Appendix 4 Individual director self and peer questionnaire	257
Instruction sheet	257
Part A: General performance	258
Part B: General questions	259
About the authors	261
Index	263

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Our approach to board evaluations has been developed and refined from over 25 years' experience working with Australian boards. As such, we are grateful to our clients who have contributed to this book by challenging our work and requiring us to answer their difficult questions.

We also thank the team at the Australian Institute of Company Directors, especially Javier Dopico, for helping to make the book a reality. Of course, if there are any errors, they are our own.

Preface

One evening more than a decade ago, a chair leaned across the table at a board dinner and whispered to one of the authors, “It’s such a relief that went well. Our last effort was such a disaster”.

Always eager to learn, an obvious question sprang to mind: “Why—what happened?”

“Well, it was about five years ago. At the end of the day’s discussions, the board adjourned for what we thought was a well-earned social dinner. The consultant had other ideas, and rose from his seat to commence reciting a self-authored poem to the group. You might think that amateur poetry was bad enough, but it turned out he had spent the afternoon working the flaws of each director into a verse for each. Nine excruciating verses later ...”

While boards need feedback to improve, this strange but true anecdote highlights a reality you need to confront if you are thinking of reviewing your board; reviews don’t always help. In some circumstances, they can actually cause harm.

But, they can add real value. After being involved in more than 1,000 reviews, we firmly believe it is possible to develop a value-adding evaluation for every board, no matter what the circumstances and challenges are.

Indeed, this is exactly why we wrote this book—to help you to design a board evaluation that will work for your board. Our experience has been that most directors are not experts in research and change management—which means that boards most often approach the challenge of developing a review process with quite limited tools. They often fall back on a standardised questionnaire or, at best, a generic interview process.

What we have tried to do is provide you with an explanation of what is possible in terms of a board and director review and how to decide which approach you should take. We hope you will find this book useful and that it will help in developing an approach to ensure that your board gets the feedback it needs. Oh, and a spoiler alert—we won’t be recommending bad poetry!

Chapter 1

Overview

Annual board evaluations are now commonplace for both for-profit and not-for-profit (NFP) organisations, with specific board evaluation recommendations forming a key component in nearly every major corporate governance standard, review or report (see Table 1.1). For example, a 2011 survey into disclosure of compliance with the (ASX) Corporate Governance Council’s (ASXCGC) Corporate Governance Principles and Recommendations (ASX Principles) found that 84 per cent of ASX 200 companies had undertaken a board evaluation within the reporting period.¹ Similarly, Australian directors in a 2016 global survey of directors conducted by international consulting firm Spencer Stuart, reported that 90 per cent of their boards conducted performance evaluations, which was higher than the global average of 68 per cent.²

Board and individual director evaluations are critical because individuals and groups need feedback on performance if they are to continue to grow and improve. There are few business units, work teams or employees in well-run businesses who are not subject to the regular discipline of performance evaluations. These evaluations allow companies, groups and individuals to anticipate possible difficulties and encourage continuous improvement.

1 Boardroom Partners and Chartered Secretaries Australia, 2012, *Anything to Declare? A Report Examining Disclosures About Board Reviews, Identifying Good Practice and Encouraging Progress*, Chartered Secretaries Australia and Boardroom Partners Pty Ltd, Sydney, p 5.

2 Spencer Stuart, 2016, “2016 Board of Directors Survey: Australian Summary”, Promoting board turnover, July 2016, <https://www.spencerstuart.com/research-and-insight/2016-board-of-directors-survey-australian-summary> (accessed 19 May 2017).

Table 1.1: Board evaluation recommendations

Source	Recommendation
ASX Corporate Governance Principles and Recommendations	"A listed entity should: (a) have and disclose a process for periodically evaluating the performance of its senior executives; and (b) disclose, in relation to each reporting period, whether a performance evaluation was undertaken in the reporting period in accordance with that process." ³
APRA Prudential Standard CPS 510 Governance	"The Board of a locally incorporated APRA-regulated institution must have procedures for assessing, at least annually, the Board's performance relative to its objectives. It must also have in place a procedure for assessing, at least annually, the performance of individual directors." ⁴
Boardroom Behaviours: A Report Prepared for Sir David Walker by ICSA	"High standards of rigorous and, occasionally, independent evaluation are needed to increase boards' effectiveness. Generally, further emphasis should be placed on the means for ensuring accountability in the areas of individual director and whole board performance." ⁵
New Zealand Corporate Governance Forum Guidelines	"The board should have rigorous, formal processes for evaluating its performance, along with that of board committees and individual directors, including the chairperson. This could extend to formally reviewing the position of chairperson on a regular basis." ⁶
NYSE Listed Company Manual	"The board should conduct a self-evaluation at least annually to determine whether it and its committees are functioning effectively." ⁷
Singapore Code of Corporate Governance	"There should be a formal annual assessment of the effectiveness of the Board as a whole and its board committees and the contribution by each director to the effectiveness of the Board." ⁸
UK Corporate Governance Code	"The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors." ⁹

3 ASXCGC, 2014, *Corporate Governance Principles and Recommendations*, 3rd edn, Australian Securities Exchange Ltd, Sydney, p 13.

4 Australian Prudential Regulation Authority (APRA), 2017, "Prudential Standard CPS 510 Governance", Board performance assessment, p 11, para 44, July 2017, [http://www.apra.gov.au/CrossIndustry/Documents/Prudential-Standard-CPS-510-Governance-\(July-2017\).pdf](http://www.apra.gov.au/CrossIndustry/Documents/Prudential-Standard-CPS-510-Governance-(July-2017).pdf) (accessed 19 May 2017).

5 Institute of Chartered Secretaries and Administrators (ICSA), 2009, *Boardroom Behaviours: A Report Prepared for Sir David Walker by the Institute of Chartered Secretaries and Administrators (ICSA)*, Institute of Chartered Secretaries and Administrators, London, p 6.

6 NZ Corporate Governance Forum, 2017, "New Zealand Corporate Governance Forum Guidelines", 02 Board Composition and Performance, <http://www.nzcgf.org.nz/guidelines/02-board-composition-performance/> (accessed 17 May 2017).

7 New York Stock Exchange, 2009, "NYSE Listed Company Manual", 303A.09 Corporate Governance Guidelines, http://nysemanual.nyse.com/lcm/Help/mapContent.asp?sec=lcm-sections&title=sx-ruling-nyse-policymanual_303A.09&id=chp_1_4_3_10, (accessed 17 May 2017).

8 Monetary Authority of Singapore, 2012, "Code of Corporate Governance", Board membership, p 11, para 5, 2 May 2012, http://www.mas.gov.sg/~media/resource/fin_development/corporate_governance/CGCRevisedCodeofCorporateGovernance3May2012.pdf (accessed 17 May 2017).

9 Financial Reporting Council, 2016, *The UK Corporate Governance Code*, Financial Reporting Council, London, p 5.

But are boards using performance evaluations to ensure they are as effective as their shareholders or members expect them to be? How do directors know whether the process their board uses to evaluate its performance will deliver the outcomes the board requires? Does the board see the value in evaluating itself and its directors? Perhaps a major factor in these questions being pertinent to many boards lies in the limited guidance available on why and how boards should conduct an effective evaluation process. Professional bodies such as the National Association of Corporate Directors (NACD) in the US, the Institute of Directors (IoD) in the UK and the Australian Institute of Company Directors (AICD) have recognised the need to develop performance standards and advice for boards. However, it is often difficult to find information that provides a wide-ranging approach to board evaluations.

Our objective in writing this book is to provide a pragmatic and helpful resource for those seeking information on how to carry out a board evaluation. In particular, we aim to present a variety of approaches to board evaluations that will enable any board to tailor an appropriate mechanism to carry out a governance evaluation within its particular context. Thus, we cover topics on evaluating the performance of the board as a whole, individual directors, chairs and committees.

The remainder of this chapter has two components. First, we outline our framework for the board evaluation process and then the structure for the remainder of the book.

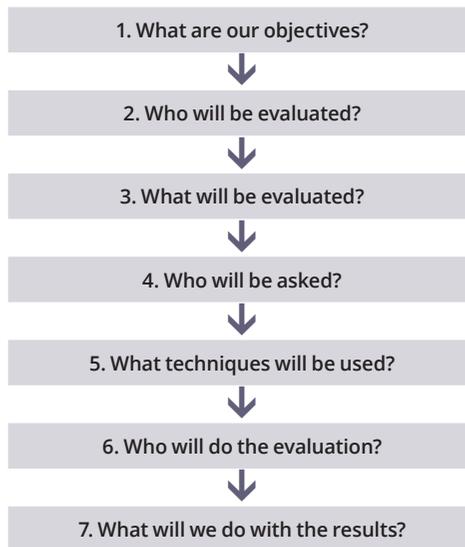
1.1 Framework for a board evaluation

Although boards differ in the severity of their performance problems, the competitive environment in which they work, and the range of performance issues they face, there are a number of key decisions that are relevant to all boards implementing an evaluation process. The objective of this section is to provide a framework for boards to use when deciding how to go about performance evaluation. In this model, we suggest there are seven key questions to consider when planning a board evaluation. These are illustrated in Figure 1.1 and in this section we outline seven steps to take in order to develop a framework for board evaluation.

Establishing a framework for a board evaluation is a sensible approach for all types of organisations that seek to conduct an effective evaluation process. While

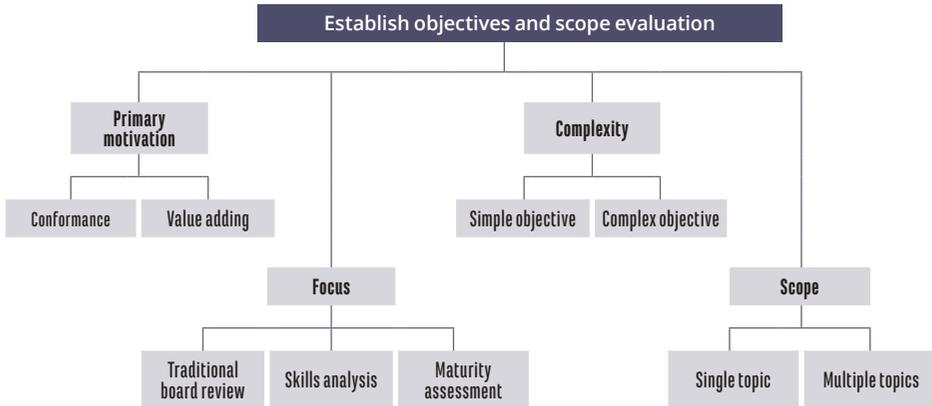
we have described our framework as a sequential series of events, in practice, most boards will not follow such a linear process. Some of these decision areas will be reached simultaneously, for example, ‘Who will be evaluated?’ may be decided at the same time as ‘Who will do the evaluation?’ Other issues may tend to dominate the planning. For example, scarce resources may dictate an internal review. Importantly, we would recommend that the board keep the end in mind throughout the process.

Figure 1.1: Framework for a board evaluation



1.1.1 What are our objectives?

The first stage of the board evaluation process is to establish what the board hopes to achieve. Clearly identified objectives enable the board to set specific goals for the evaluation and make decisions about the scope of the review. Such issues as the complexity of the performance problem, the size of the board, the stage of organisational life cycle and significant developments in the organisation’s competitive environment will determine the issues the board wishes to evaluate. These early decisions about overall objectives and resource allocations are critical to the success of the process.

Figure 1.2: What are our objectives?


Similarly, the scope of the review—how many people will be involved, how much time and money to allocate—will be determined by the severity of the problems facing the board and the availability of sufficient resources (human, financial, time) to carry out an evaluation. Chapter 3 discusses the importance of defining overall objectives. These early decisions about overall objectives and resource allocations are critical to the success of the process.

With clear objectives, it is relatively easy to decide whose performance will be evaluated, who the most appropriate people are to assess performance and the person or group best suited to conducting an evaluation. Similarly, the choice of measurement techniques and decisions on how to disseminate the results of the evaluation, are readily determined once decisions have been made concerning the earlier questions.

As Figure 1.2 highlights, when the board's objectives are established, conducting a more traditional board review for conformance and/or value-adding purposes may not be the best option. For example, if the board is concerned about the knowledge, skills and experience of current directors and wishes to establish what skills it needs in the coming years, a skills analysis would be the most appropriate means. On the other hand, if the chair knows the board is not working to its full potential, but is unsure why, the complexity and scope of the board evaluation can be widened to find the root cause of the board's problems.

1.1.2 Who will be evaluated?

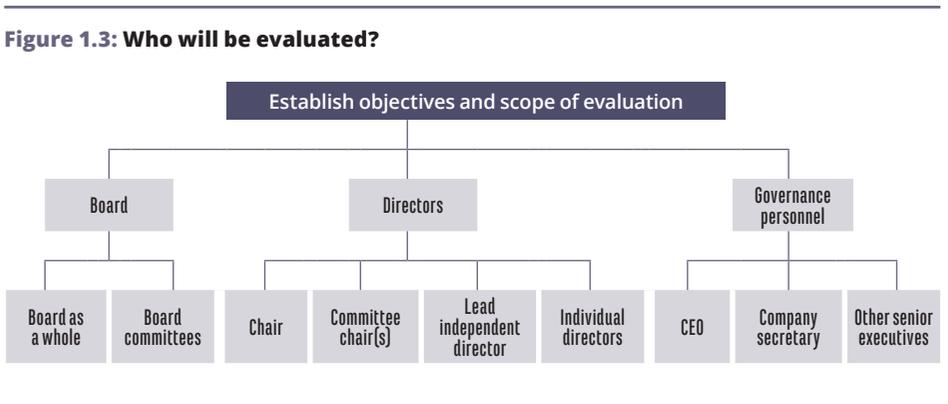
Along with establishing objectives, it is important to decide whose performance will be appraised to achieve those objectives. Chapter 4 discusses evaluation of the board as a whole, individual directors, the chair, board committees and the CEO. Evaluation of the board as a whole is the most common and important practice for developing shared performance expectations between board members. The purpose of evaluating the board as a whole is to assess how effectively the board is meeting performance expectations and contributing to the achievement of organisational objectives.

Boards looking beyond group performance to individual performance evaluate individual directors and, in some instances, the chair’s performance. Self- or peer-evaluation techniques may be used, depending on the board’s level of comfort with the evaluation process and the types of issues that the board is trying to assess.

For those organisations that have committees to manage the board’s workload, committee and committee chair evaluation can be a valuable process. For example, the current media focus on accounting standards may encourage boards to reassess the effectiveness of their audit committees, to ensure that all policies and procedures conform to current leading practice guidelines.

Finally, the most common form of performance evaluation is the board’s assessment of the CEO. Since hiring, evaluating, rewarding and, where necessary, firing the CEO are key board functions, assessing the CEO’s performance is an essential requirement of good corporate governance.

Figure 1.3 illustrates the choices when deciding who will be evaluated.



1.1.3 What will be evaluated?

The third stage in establishing a framework for a board evaluation involves deciding the criteria for the evaluation process. As we have noted, boards are generally looking for performance improvements in the areas of board processes, director skills and relationship building. In Chapter 5, we discuss how the board can translate concerns in these areas into specific activities that will lead to performance improvement.

To cover the range of objectives the board may have, including meeting any compliance requirements, board evaluations generally use some form of leading practice framework. There are many such frameworks available and we will discuss several of these in Chapter 5.

1.1.4 Who will be asked?

Step four in establishing an evaluation framework is to decide whom to approach to provide feedback on the board's performance. Chapter 6 discusses the options with regard to both internal and external reviews. If the decision has been made to conduct an internal review, most boards choose to confine the evaluation to board members themselves. However, under certain circumstances, it may be important to ask the CEO and senior management team to give their views on the performance of the board. There may even be a need to consult other managers and employees of the firm, as long as they have direct access to the board and can give useful feedback that relates specifically to board performance.

In the case of external evaluations, shareholders and financial markets, customers, governments, suppliers and other key stakeholders can all be asked to participate in the evaluation of the board, depending on the significance of their relationship to the firm, and the closeness of their contacts with board members. Figure 1.4 illustrates the people who can potentially provide helpful feedback on the board's performance.

1.1.5 What techniques will be used?

Selecting the most appropriate measurement techniques for the objectives is another important decision. Chapter 7 discusses the various measurement techniques that are appropriate for performance evaluation. Depending on the degree of formality of the evaluation, its objectives and the resources available, there are a number of qualitative and quantitative techniques that may be employed. Qualitative techniques

Figure 1.4: Who will be asked?

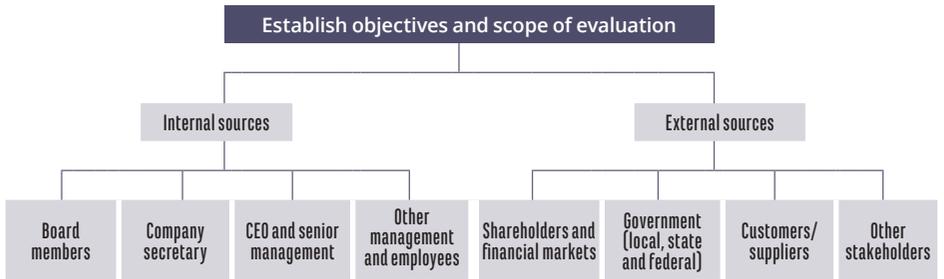
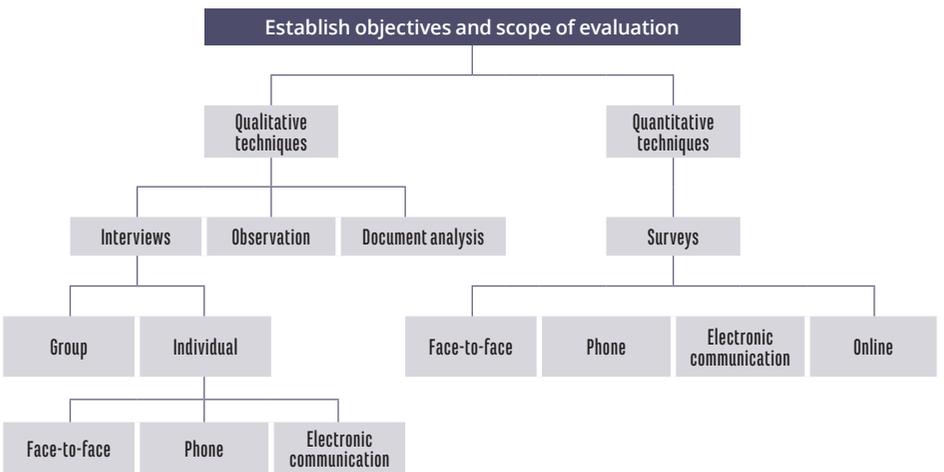


Figure 1.5: Evaluation techniques



include in-depth interviews, observation and document analysis. Of these, interviews are frequently used because of their versatility. They can be formal or informal, conducted with groups or individuals. Similarly, they can be conducted face-to-face, or via phone or video conference, if time or distance are important considerations.

Surveys are the other most common research technique. They form the basis of all quantitative analysis and have the added advantage of being able to capture qualitative data as well. For example, apart from the scaled questionnaire on which quantitative analyses are performed, open-ended, qualitative questions inviting

director feedback can also be incorporated into a survey. This makes them a very versatile research tool. Surveys can be administered face-to-face, by phone, video conference or other forms of electronic communication such as email or via an online questionnaire. Figure 1.5 illustrates the various data collection techniques.

1.1.6 Who will do the evaluation?

The next consideration in establishing your evaluation framework is to decide who the most appropriate person is to conduct the evaluation. If the review is an internal one, the chair commonly conducts the evaluation. However, there are times when it may be more appropriate to delegate either to a non-executive or lead director, or to a board committee. In the case of external evaluations, specialist consultants or other general advisers with expertise in the areas of corporate governance and performance evaluation may lead the process. There are also online providers who can conduct an evaluation over the internet, although these evaluations tend to be generic. Chapter 9 discusses the advantages and disadvantages of using internal and external reviewers. Figure 1.6 illustrates the choices for determining who will perform the evaluation.

1.1.7 What will we do with the results?

The final step in planning the framework for your board evaluation is to determine how, and to whom, the results will be distributed. In Chapter 10, we discuss communication of the results to internal and external stakeholders. Internally, this may include the board only, the board and senior management team or broader dissemination

Figure 1.6: Who will do the evaluation?

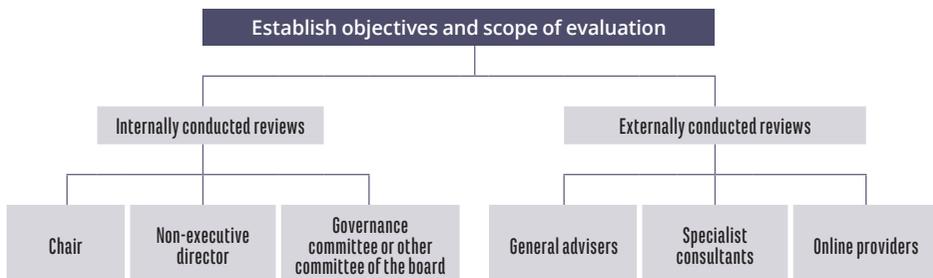
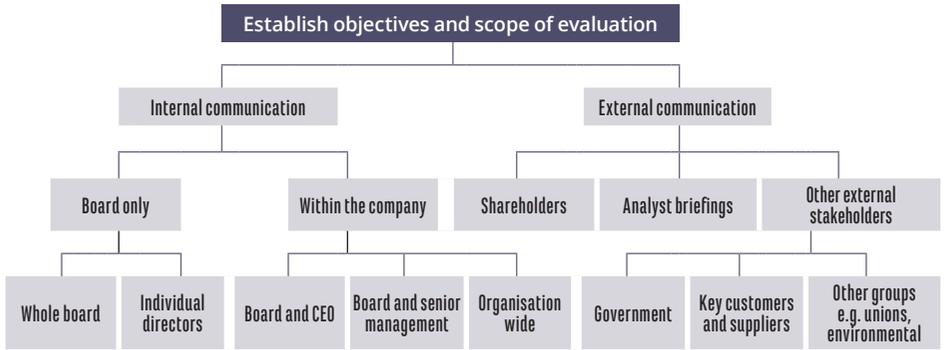


Figure 1.7: What will we do with the results?



throughout the organisation. When communicating with external stakeholders, boards most commonly release information as part of the annual report or in some other form of shareholder communication such as the corporate governance section of the company’s website. However, the results may also be disseminated at analysts’ briefings or to key stakeholder groups, depending on the original objectives of the evaluation. Figure 1.7 illustrates the dissemination options.

1.2 Conclusion

Establishing a framework for a board evaluation is a useful approach for all types of organisations seeking to conduct an effective evaluation process. This means that while each of the seven topic areas will need to be carefully considered, the steps may not necessarily be sequential and at times may even occur concurrently. Whether your company is listed on the stock exchange, a small family company or an NFP, this framework can be used to develop an evaluation process appropriate to your organisation.

In the next chapter, we will discuss the benefits of conducting a board evaluation as well as providing responses to the barriers directors may raise when a review of the board’s performance is suggested. The remainder of this book details each of the seven decision areas for the board evaluation process. We conclude with a chapter on how a board can effectively implement a board or individual director evaluation.