

Performance review and appraisal of the CEO

Governance relations

Accountability for performance outcomes is a key tenet of good corporate governance, and as the most senior executive in the organisation it is important that the Chief Executive Officer (CEO) is held to account by the board.

Although the board should exercise this function on a continuous basis, it is good governance practice to set aside time, at least annually, to dedicate to a more formal performance review and appraisal of the CEO. Many organisations also incorporate the CEO's annual remuneration review in that process.

The principles of the performance review and evaluation process might include:

- Continuous improvement;
- Review and assessment of historical performance against:
 - job description and expectations
 - key performance indicator sets
 - organisation's code of conduct and ethical value base
 - organisation's objectives;
- Identification of:
 - any impediments to enhanced performance
 - professional development and training opportunities to improve future performance;
- Agreeing any initiatives or developmental opportunities arising from the review;

- Setting of key performance indicators for the future to align performance expectations with the organisation's strategic objectives;
- Review of remuneration arrangements and adjustments as appropriate including:
 - performance against last year's incentivised remuneration key performance indicators (as may have been set) so as to determine any accrued incentive remuneration benefits due
 - benchmarking remuneration against industry norms and CPI movements
 - establishment of future incentivised remuneration terms (if and as applicable) against ongoing key performance indicators and outcomes.

Assessing the performance of the CEO is the responsibility of the entire board although boards often delegate management of the task to a committee of the board. The CEO is the link between the board and the management team in the governance of the organisation, so the board has a vested interest in the CEO being effective. Ensuring the CEO meets performance expectations is also important due to an increased focus on governance accountability generally.

Why conduct an appraisal?

The board and the CEO share the responsibility of ensuring that the organisation meets its objectives. Common expectations that boards have of their CEOs include showing leadership and strategic vision, having a high level of business judgement and the ability to meet performance targets while working towards longer term goals.

The board's expectations of the CEO's performance should be communicated to the CEO in advance – that is, in the CEO's letter of appointment or employment contract – and thereafter progressively as the prioritisation or emphasis of those expectations may change in response to the changing dynamic environment and circumstances of the organisation.

The benefits of evaluating the CEO include:

- promotion of good CEO and board relations;
- clarification of the strategic direction and to ensure that the board and CEO are moving in the same direction;
- provision of early warnings of potential problems;
- to focus the CEO's attention on the CEO's accountability for performance;
- encouragement of the development of the CEO's skills and attributes.

However, a poorly done performance appraisal can demotivate and cause disharmony between the board and CEO. Care should be taken to ensure that the appraisal does not become a governance box-ticking exercise.

How to conduct an appraisal?

Desirably, the process should begin before the new financial year commences so that performance objectives which reflect the organisation's strategic objectives and priorities can be agreed upon. The starting point is to define the parameters and objectives of the appraisal.

- Who is responsible for the process? Usually it will be the chair or it may be delegated to the chair of nominations or remuneration committees or a small delegated sub-committee for that purpose.

- What will be evaluated? Will information be qualitative or quantitative? Is it financial performance, stakeholder relations, relations with the board, input into strategy formulation, strategy implementation? If analysing CEO behaviours, quantitative measures may not be appropriate.
- What are the anticipated outcomes?
- Who will contribute feedback? Directors only? Will it be a 360° appraisal where the CEO's subordinates (that is, the senior executives) provide feedback as well?
- How will the information be gathered? Will it be through informal chats, formal interviews, questionnaires?
- Will the CEO have the opportunity to present a self-assessment to the review group? What does the CEO see as his/her key achievements for the year and where they believe they are headed in the coming year?

These agreed parameters should be communicated and agreed to in advance by the CEO.

The next step is to gather information by whatever method or combination of methods have been agreed upon. The results are then compiled and presented to the board (perhaps initially via the relevant sub-committee if appointed) for discussion. When a consensus view has been reached, a final report can be prepared.

The results can then be given to and discussed with the CEO. As this can be a sensitive time it is suggested that at least two directors be present to ensure that it is not presented as one person's view and that a more complete picture is given. The evaluation should be given verbally but be supported by a written document. The outcomes of the appraisal will assist in setting goals for the CEO in the following year.

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An example of a reasonably traditional review and evaluation process appears:

1. (Timing) Reviews and evaluations should take place:
 - consistent with the CEO's employment contract;
 - whenever considered appropriate by the organisation in case of special need or concern;
 - at least annually.
2. (Process) Reviews and evaluation should include:
 - accepted human resource industry standards for such reviews including the prospect of 360o feedback review processes as may be appropriate from time to time;
 - facilitated by the board chair (or chair of Nomination or Remuneration Committees) or an external facilitator;
 - provision of sufficient and appropriate information to both the reviewer and the reviewee to assist the integrity of the review and any performance benchmarking to be considered as part of the review;
 - an agenda for the review including key issues to be discussed as part of the review;
 - sufficient advance notice of the review to be given to reviewer and reviewee to allow time for proper reflection and preparation;
 - the review itself being conducted in an open and transparent manner with a view to constructive criticism on areas for improvement and acknowledgement of areas of past achievement.
3. (Recording):
 - notes prepared by the facilitator arising from the review, including agreed initiatives arising, key performance indicators for the future, and any variation to job description/scope or remuneration;
 - the notes also being given to the reviewee for formal acceptance as a fair record of the review;
 - details of the review process and outcome being confidentiality recorded in the organisation's corporate HR records.

Should there be ongoing evaluation?

The CEO's performance should be monitored and constructive feedback given by the chair (after consultation with the board) on an ongoing basis (perhaps at least quarterly) rather than once or twice a year only. This alerts the board to potential issues or problems arising and provides opportunities for the board and CEO to work to overcome them before they escalate. Providing timely and constructive feedback to the CEO also promotes trust and respect between the board and CEO.

What are some other considerations?

Distinguish between the CEO's and the organisation's performance, although the two may be closely related. What is happening in the broader external market – economic slowdown, price wars with competitors, etc. – can impact on an organisation's performance but may not be directly attributable to the CEO. The CEO can perform strongly even when the organisation does not.

Only evaluate the things for which the CEO has responsibility (including by way of delegated authority and oversight).

Separate the initial appraisal element of the review from the remuneration element of the review because it can skew short term performance and sometime lead to selective analysis and presentation of supporting data.

Focus primarily on the extent to which the outcomes for which the CEO is responsible meet the board's expectations, not on the personal attributes, although these may be relevant as well as part of ongoing personal professional development for the CEO.

Give praise and constructive criticism in a timely manner – don't just save it up for once a year.

Even if the appraisal is delegated to a board committee, the whole board retains responsibility and should have input.

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