

# Board Evaluations: Why they Matter and How they Should be Conducted

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## **Abstract**

*When board directors take ownership of the board assessment/evaluation process, their meetings proceed more smoothly, they make better decisions, they are able to detect specific deficiencies in the existing board working arrangements, there is enhanced ability to monitor managerial performance, they have greater influence on long-term corporate strategy, and there is improved performance and accountability of the company. However, this can only be achieved upon full comprehension of the entire board evaluation processes.*

## **1. Introduction**

Board evaluations have often been viewed as a means of assessing whether the board, as a whole and its individual members, have adequately executed their objectives, responsibilities and duties. Recent developments in board evaluations reveal that evaluations should not only be premised on performance of duties and responsibilities, but also on whether the board's structure, composition, operations and dynamics are well suited for effective performance of board. This is because the effectiveness of a board is hinged on a myriad of factors, such as its structure and composition, the dynamics and operations of the board, its processes, procedures and internal controls.

This paper seeks to highlight and analyse, by giving examples, the various aspects of board evaluations, namely, features of effective board evaluations, evaluation methodology, goals of evaluations, possible outcomes of evaluations, benefits of evaluations and challenges of board evaluations.

## 2. Justification for Board Evaluations

The need for board effectiveness has been occasioned by factors that have shaped corporate governance over the years, namely, pressure from stakeholders for short-term and long-term corporate performance, board oversight failures, evidenced by recent examples,<sup>1</sup> statutory requirements in certain jurisdictions,<sup>2</sup> and increased risks and opportunities in the business environment that require good governance.

Boards are tasked with various responsibilities such as: providing overall leadership for the company, scrutinizing and approving company policies, financial statements, strategies, investment proposals and budgets and appointing senior executives of the company. These roles and responsibilities can be summarized to three main ‘umbrella’ roles, that is, it is required to provide strategic direction for the organization, monitor the management of the organization and advise management.<sup>3</sup> The Companies Act, 2015 identifies the most notable duties of directors to be: “to promote the success of the company, to act within the powers prescribed by the Act and company’s constitution, to exercise independent judgment, to exercise reasonable care and skill, to avoid and or declare conflicts of interest, to not accept benefits from third parties, not make unauthorized profits and to adhere to confidentiality”.<sup>4</sup>

In the governance of State Corporations in Kenya, the Code of Governance for State Corporations (Mwongozo Code) stipulates the functions of the board as a whole and duties of individual board members. The functions of the board identified therein include: to execute their roles collectively, to establish the overall strategy of the organization, evaluate the

<sup>1</sup> Michael Schlossberg, Three Dramatic Board Failures to Learn from (2022). <https://www.thecorporategovernanceinstitute.com/insights/guides/three-dramatic-board-failures-to-learn-from/>. Accessed on 25<sup>th</sup> August, 2022.

The article highlights the case of Sports Direct, Enron and Blockbuster. These companies fell because of a myriad of reasons, however, there is a recurring concern for all the three companies. That is, the training of board directors had been ignored and therefore directors lacked capacity to make sound decisions.

<sup>2</sup> For instance, in India, under their Companies Act 2013, annual board evaluations are mandatory.

<sup>3</sup> Deloitte, *Performance Evaluation of Boards and Directors*, (2014). <https://www2.deloitte.com/content/dam/Deloitte/in/Documents/risk/Corporate%20Governance/in-cg-performance-evaluation-of-boards-and-directors-noexp.pdf>. Accessed on 25<sup>th</sup> August, 2022.

<sup>4</sup> The Companies Act, no 17 of 2015, sections 140-150.

organization's overall performance, approve the organizational structure and annual budget, hire senior executives of the organization amongst other roles.<sup>5</sup> On the other hand, the duties of individual board members under the Code include, *inter alia*, ensure transparency and accountability of the board, exercise confidentiality, independent judgment, duty of care, diligence and skill while discharging their duties, protect and promote the image of the organization.<sup>6</sup>

With the duties and responsibilities of boards and directors outlined in various instruments and policies,<sup>7</sup> board evaluations have been identified as the best approach of assessing board effectiveness.

### 3. Objectives of Board Evaluations

The evaluation methodology and process is pegged on the specific goals and objectives of board evaluations. Best practices around the world reveal that board evaluations should not just be a measure of whether the Board and directors have fulfilled their duties and responsibilities but should also be an assessment to the environment under which they perform their duties.<sup>8</sup> The evaluation should also examine whether the board's structure and composition, operations and dynamics, are suitable for the effective and efficient performance of the board.<sup>9</sup>

The evaluation of a board structure and composition entails examining at the board and committee charters (if the board has committees), competencies of directors, diversity of the board and board processes.<sup>10</sup> Evaluation of dynamics of the board involves examining the interactions

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<sup>5</sup> Mwongozo- Code of Governance for State Corporations, 2015, 3-4.

<sup>6</sup> Ibid.

<sup>7</sup> Respective company policies and statutory instruments of a country.

<sup>8</sup> Steve Klemash, et.al., Effective Board Evaluation (2018). Harvard Law School Forum on Corporate Governance. <https://corpgov.law.harvard.edu/2018/10/26/effective-board-evaluation/>. Accessed 25th August, 2022.

<sup>9</sup> Deloitte, Performance Evaluation of Boards and Directors, (2014). <https://www2.deloitte.com/content/dam/Deloitte/in/Documents/risk/Corporate%20Governance/in-cg-performance-evaluation-of-boards-and-directors-noexp.pdf>. Accessed on 25th August, 2022.

<sup>10</sup> Ibid.

and communication between board members, board members and the chair, the board with management, the board with stakeholders. Board dynamics also comprises the quality of participation of directors in board meetings and cohesiveness of the board as a whole.<sup>11</sup>

Identifying the key areas to evaluate is a necessary step when formulating the specific goals and objectives of board evaluations. For instance, if one of the parameters to be evaluated is board dynamics, then the objective of such an evaluation would be to elicit candid feedback from board members on how they feel about their interactions with fellow board members. The evaluation of board structure and composition might elicit the objective of identifying whether the structure and composition of the board is adequate for the performance of the board or whether their gaps requiring inclusion of certain members or committees. Notwithstanding, the specific areas to be evaluated, there are certain goals of board evaluations that cut across. These include: assessing the director's knowledge on the workings of the organization, examining the sufficiency and balance of skills, experience and knowledge and the board and its committees, pinpointing weaknesses of the board and its members that ought to be remedied and gathering information on the workings and effectiveness of the board for purposes of apprising stakeholders on the corporate governance of the organization.<sup>12</sup>

Additionally, Geoffrey Kiel suggests a 'seven-step framework' of conducting board evaluations. This framework advances seven questions that ought to be answered before the evaluation is done.<sup>13</sup> These are: What are the objectives? Who will be evaluated? What will be evaluated? Who will be asked? What techniques will be used? Who will do the evaluation? And what will be done to the results?<sup>14</sup>

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<sup>11</sup>Ibid.

<sup>12</sup>Business Roundtable, *Principles of Corporate Governance* (2016). Harvard Law School Forum on Corporate Governance. <https://corpgov.law.harvard.edu/2016/09/08/principles-of-corporate-governance/>. Accessed on 25<sup>th</sup> August, 2022.

<sup>13</sup>Geoffrey Kiel et. al., *Board Performance Evaluations that Add Value*. Harvard Law School Forum on Corporate Governance. <https://corpgov.law.harvard.edu/2018/05/18/board-performance-evaluations-that-add-value/>. Accessed on 25<sup>th</sup> August, 2022.

<sup>14</sup>Ibid.

#### 4. Evaluation Methodology

Unless prescribed by law, board evaluations are elective. This leaves room for flexibility of the evaluation methodology and process, hence the reason why the process can be tailored to the organization's needs.

Methods of carrying out board evaluations include: having board members fill questionnaires, conducting interviews with directors, assessing skills and competencies by asking questions or through document reviews.<sup>15</sup> It is recommended that evaluation questions should be precise and address the core areas for evaluation. In Kenya for instance, the State Corporations Advisory Committee has formulated a Guide to Self-Evaluation and standardized self-evaluation forms for board members in State Corporations.<sup>16</sup> The questions in the forms range from attendance of meetings, comprehension of roles and responsibilities, exercise of skill, duty of care and diligence, matters on transparency and accountability and leadership of the chairperson.<sup>17</sup> Interestingly, the questions on interactions between members and assessment of members' personalities are not provided for in these forms, leaving a lacuna on evaluation of board dynamics in Kenyan parastatals.

Boards are at liberty to undertake their own board evaluations or may seek the services of a third party for a more objective approach and analysis. In some large global corporations, one of the board committees, the nomination committee, is tasked with the role of conducting board evaluations.<sup>18</sup> While there are no differing opinions on whether board evaluations are important, there are divergent views on evaluation of individual directors. Some governance experts suggest that peer evaluation

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<sup>15</sup>NASDAQ, *What is Board Evaluation?* (2022). <https://www.nasdaq.com/solutions/governance/board-evaluations/what-is-a-board-evaluation>. Accessed on 25<sup>th</sup> August, 2022.

<sup>16</sup>State Corporations Advisory Committee, Board Evaluation forms: BE1 Board Self Evaluation, BE2 Chairperson of the Board, BE3 Board Self Evaluation, BE4 Chief Executive Officer's Performance Evaluation, BE5 Evaluation of the Corporation Secretary, (2015). <https://www.scac.go.ke/2015-02-16-09-56-36/board-evaluation>. Accessed on 25<sup>th</sup> August, 2022.

<sup>17</sup>Ibid.

<sup>18</sup>Deloitte, *Performance Evaluation of Boards and Directors*, (2014). <https://www2.deloitte.com/content/dam/Deloitte/in/Documents/risk/Corporate%20Governance/in-cg-performance-evaluation-of-boards-and-directors-noexp.pdf>. Accessed on 25<sup>th</sup> August, 2022.

of a fellow director by a fellow director can inhibit relations between directors and ultimately impact board dynamics negatively and, therefore, recommend self-evaluation of directors or evaluation by an independent third party.<sup>19</sup> The benefits of involving an independent third party in the evaluation process enhances objectivity and integrity, removes bias and increases confidence in the outcomes of the evaluation process.

Board evaluations best practices vary from country to country. In Argentina, the Code of Good Practices in Corporate Governance requires the board of directors of listed companies to evaluate its performance annually, prior to the annual ordinary shareholders meeting.<sup>20</sup> In Brazil, the Best Practices in Corporate Governance, obliges that board evaluations be conducted annually and that the board assessment method be made in accordance to the circumstances of the organization. The Brazil Code bestows the task of conducting board assessments on the Chairperson of the Board and provides that individual assessments of board members should encompass their attendance of meetings and member's involvement in meetings, as these factors are essential for future re-elections.<sup>21</sup> The OECD Principles of Corporate Governance recommends board evaluations for purposes of establishing whether the board has the correct mix of competencies and backgrounds.<sup>22</sup> In South Africa, the King IV Report on Corporate Governance stipulates that a board should evaluate itself and its board members at least once a year.<sup>23</sup> It adds that the evaluation process should be spearheaded by an independent non-executive member.<sup>24</sup> In

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<sup>19</sup>Ibid.

<sup>20</sup>Corporate Secretaries International Association, *Special Report, Global Board Evaluation Practices and Trends; Lessons for the Corporate Secretary: The Five Key Take Aways* (2016). <https://www.chartsec.co.za/documents/members/Global%20board%20evaluation%20practices%20and%20trends.pdf>. Accessed on 25<sup>th</sup> August, 2022.

<sup>21</sup>Corporate Secretaries International Association, *Special Report, Global Board Evaluation Practices and Trends; Lessons for the Corporate Secretary: The Five Key Take Aways* (2016). <https://www.chartsec.co.za/documents/members/Global%20board%20evaluation%20practices%20and%20trends.pdf>. Accessed on 25<sup>th</sup> August, 2022.

<sup>22</sup>Ibid.

<sup>23</sup>Ibid.

<sup>24</sup>Ibid.

the United States of America, the New York Exchange (NYSE) Corporate Governance Guidance requires committees of all listed companies to conduct self-evaluations at least once a year.<sup>25</sup> The Indian Companies Act, 2013 provides that board evaluations of committees and individual directors is mandatory.<sup>26</sup> In Kenya, there is no statutory requirement for board evaluations, however, state corporations are required, under the Mwongozo Code, to carry out annual board evaluations. This is expected to be led by the Chairperson using a board evaluation tool, and should assess the board as a whole, its committees, individual members, the corporation secretary and the CEO.<sup>27</sup>

## 5. Outcomes of Board Evaluations

The Mwongozo Code stipulates that at the end of the annual board evaluation, a report with recommendations for enactment should be made and shared to all stakeholders.<sup>28</sup> The Code further provides that the outcome of the evaluation should inform the re-appointment of a member or the chairperson.<sup>29</sup> This practice is not only evident in state corporations, but also in public and private companies. The outcomes of board evaluations may range from: review of board processes, changes in board composition and committees' compositions, elimination of factors that bring dysfunctionality to the board amongst other outcomes.

Unfortunately, the Mwongozo Code does not provide timelines within which the evaluation report should be made and shared. This poses risks to the relevance of the recommendations because if too much time is taken to prepare and share the evaluation report, then the relevance of the recommendations may diminish. Additionally, the said recommendations will not materialize unless an implementation plan is in place and is timely executed.

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<sup>25</sup>Ibid.

<sup>26</sup>Ibid.

<sup>27</sup>Mwongozo- Code of Governance for State Corporations, 2015, 9-10.

<sup>28</sup>Mwongozo- Code of Governance for State Corporations, 2015, 9-10.

<sup>29</sup>Ibid.

## 6. Benefits of Board Evaluations

The continual use of board evaluations to assess board effectiveness is attributed to the fact that benefits from these evaluations outweigh the costs and time involved in conducting them. They promote accountability of board members, as it instills a sense of responsibility in the members to fulfill their obligations and ensure short-term and long-term corporate performance. The periodic board evaluations establish and embed an organizational culture where board members, management and stakeholders have high regard for board evaluations and carry on the culture of conducting them. This ensures that a culture of good governance is upheld by board members at all times.

Transparency is vital for building long term stakeholder relationships as it nurtures trust and a good reputation. Board evaluations go a long way in ensuring transparency as they reveals to stakeholders the inner workings of the board. Board evaluations also enable members to know how to better utilize their opportunities, manage risks and take corrective action plans on weak areas. Ultimately, this enables the board to effectively execute their oversight roles and be better at decision making.

Prior to the formulation of the Mwongozo Code, boards of parastatals used to operate without structure and direction, which had a negative impact on their overall performance of these organizations. This narrative has changed and public entities now have more efficient boards.<sup>30</sup>

## 7. Challenges of Board Evaluations

As seen above, most jurisdictions recommend that the Chairperson should spearhead the evaluation process. However, more often than not, the Chairperson might not be a governance expert. This may affect the outcome of the evaluation process negatively and, therefore, calls for a need to engage a governance expert in evaluation of Boards.<sup>31</sup>

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<sup>30</sup>Juliet Nyanga'i, *Tackling Institutionalised Corruption: The Contribution of the Mwongozo Code of Corporate Governance* (2020). [https://www.linkedin.com/pulse/tackling-institutionalised-corruption-contribution-code-nyang-ai/?trk=articles\\_directory](https://www.linkedin.com/pulse/tackling-institutionalised-corruption-contribution-code-nyang-ai/?trk=articles_directory). Accessed 25<sup>th</sup> August 2022.

<sup>31</sup>NASDAQ, *What is Board Evaluation?* (2022). <https://www.nasdaq.com/solutions/governance/board-evaluations/what-is-a-board-evaluation>. Accessed on 25<sup>th</sup> August, 2022.



The criteria used in board evaluations examine aspects such as quorum, number of meetings attended, board composition and committee compositions. While assessing these factors is important, they might not translate to better performance of the board. Therefore, more emphasis should be given to those factors that drive increased board effectiveness.<sup>32</sup> These factors include: assessing skills, experience and competencies of board members, and providing the requisite training and development where gaps have been identified.

Where third parties are engaged to conduct board evaluations, the risk of lack of independence looms, as the third party may be comprised by the board members. Measures ought to be put in place to counter this.

Due to their consequences, board members may not wholly embrace board evaluations. As such, it is important that the organization's leadership communicates effectively with board members on the subject and sensitizes them on the importance of evaluation.

## 8. Conclusion

Board evaluations come with their own fair of challenges. Careful consideration has to be made on the specific goals of the evaluation, the methodology to be used has to be formulated based on best practices in corporate governance and it should endeavor to meet the identified goals of evaluation. Once evaluation is completed, a report with recommendations ought to be made soon thereafter and shared with stakeholders. Timely implementation of the recommendations is key or else the entire process might turn out to be an effort in futility. Finally, the effectiveness of board evaluations hinges on leadership. Good leadership is key in ensuring that evaluations are conducted periodically by competent persons and that recommendations are fully implemented.

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<sup>32</sup>Business Roundtable, *Principles of Corporate Governance* (2016). Harvard Law School Forum on Corporate Governance. <https://corpgov.law.harvard.edu/2016/09/08/principles-of-corporate-governance/>. Accessed on 25th August, 2022.