Assessing Board and Director Effectiveness

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**Assessment Topics**

The role of the Board of Directors is threefold: the Board opines upon the broad strategy of the company, it provides guardrails and controls with regards to company operations in pursuit of those objectives, and thirdly, it provides oversight of, and counsel to, management in execution of that strategy while acting as a fiduciary to shareholders.

Among the NCG Chairs with whom we spoke, Board assessments typically cover the following aspects of Board performance and are designed to target each of the Board’s core functions:

- Cohesion and effectiveness of Director interaction and engagement
- Quality and timeliness of Board materials, agendas, and preparedness of management
- Committee charters and Board governance and oversight effectiveness
- Board composition: skillsets, experience, and perspectives necessary to effectively counsel the company
Assessment Process

In conducting these assessments there are two main approaches to the Board evaluation process that are commonly seen:

1) Questionnaire/survey assessments often supplemented with written open-ended feedback where results are aggregated and shared back to the Board in an anonymized fashion

2) Individual interviews in which Directors are asked to provide candid feedback regarding their perspectives on Board effectiveness and performance that is then shared back to the Board in an anonymized and constructive manner

For most Boards, best practice calls for a hybrid model where survey feedback is collected on a regular basis (e.g. annually) to track Board performance on key metrics over time and supplemented with more in depth, one-on-one Director interview feedback every 18-24 months, as an additional mechanism to get more targeted and specific observations out of the process.

Several of the NCG Chairs with whom we spoke felt strongly that the most insightful and valuable parts of the entire evaluation process was getting this specific, candid, and verbal feedback from Board Members as part of the one-on-one interview process.

While regular questionnaire type evaluations can provide tactile metrics on perceived performance of the group and can be a good barometer for the health of the Board overall, there is no real substitute for collecting the specific, actionable feedback that can only be collected from a thoughtful interviewer and open and honest interviewee. Individual feedback is typically more nuanced than what can be determined using a five-point Likert scale of "strongly agree" to "strongly disagree" with respect to Board performance. As one Chair put it, "We do surveys in the off years as a method to get a pulse check on overall Board health but I would say that's generally the least effective approach – people generally say the Board is ‘great’ until you start pulling back the curtains on how and where we can be more effective and start seeking specific examples."

The third and final theme that arose out of the interviews was a need for increased communication and collaboration with the Board. The Board is an excellent resource for CEOs and should be leveraged as such. Board Members have decades of experience spanning multiple organizations and can provide valuable counsel to leadership as they work to determine strategy and develop strong organizational cultures. Historically, many CEOs have treated Board meetings as something that must be endured rather than fostering beneficial relationships. However, as we continue to encounter increasingly complex and unique challenges, it will be even more important for the CEO and Board to have a positive and transparent relationship to successfully work in lockstep. For first time CEOs, this is both a skill and relationship that can be curated with onboarding coaching as well as mentorship from a trusted Board Member.

While the COVID-19 pandemic has radically altered the way we live and work, the future of leadership is rather straightforward. Leaders will need to exercise self-awareness and humility, commit to creating a culture that is inclusive and considerate, and foster transparent and trusting relationships with Board Members.
Evaluating Performance

Strong Board evaluations strike a balance between focusing on the contributions and effectiveness of individual Directors and the broader, more holistic operations and processes of the Board as a whole. A strong evaluation process looks at the tactile aspects of process and procedure such as committee charters, materials, and agendas but also the softer aspects of performance including Board culture and engagement with management. Both aspects are critical to effective functioning and deserve ample time and focus.

Holistic Board Performance

When considering holistic Board performance, it is important to gather feedback across a variety of Board functions, responsibilities, and procedures. Here in particular, surveys can be a useful tool in gathering feedback across a wide variety of dimensions. Typical focus areas include three core areas: people, information, and process. Examples of these three core topics and example survey questions can be seen below, though variations on these themes can be easily customized and tailored specifically to a given Board or Company. Leaving questions open-ended can help to draw out more thoughtful and nuanced responses rather than simply “agreeing” or “disagreeing” as to the Board’s effectiveness in these areas.

Does the Board have the right people?

- Does the Board consist of the right number of members and are their skill sets and experiences complementary?
- Are Board members experienced and knowledgeable about the industry and core business?
- Are all Directors engaged and appropriately dedicated to their commitment?
- Are the policies on Board refreshment and succession appropriate?

Does the Board have the right information to effectuate their responsibilities?

- Do Board books contain the necessary information to ensure an effective meeting?
- Are materials provided in a timely manner to allow for proper meeting preparation?
- Is management accessible to the Board when necessary?
- Is everyone aware of the Company’s strategies and appetite for risk?

Does the Board have effective processes in place to fulfill their obligations?

- Does the Board spend enough face-to-face time on critical issues that drive future organizational success?
- Are meetings effective and structured to facilitate conversation and decision-making rather than just reviewing what has happened since last meeting?
- Are committees effective and composed of the right individuals?
- Is the Director onboarding process effective?
Individual Director Evaluation and Coaching

In addition to holistic Board performance evaluations, a majority of the NCG Chairs (62.5%) incorporated individual Director feedback as part of their evaluation process. In doing so, Board members are asked to evaluate their own performance, along with the performance of their fellow Directors in order that constructive feedback may be shared with these individuals as a means of continuing their development and functioning on the Board. Some even took the feedback gathering process a step further and asked the executive management team to provide additional feedback on individual Director performance, seeking “360 degree” feedback from as many perspectives as possible.

Just like one cannot construct a championship sports team by ignoring the chemistry between teammates, it is difficult to have a high-functioning Board while not paying attention to individual Director performance and the cohesion among the group. Asking Directors to provide feedback on their fellow Board members, their preparedness, their contributions, and their cultural “fit” within the Board can be a great mechanism to ensure that a Board is functioning well and that everyone is contributing appropriately to the success of the Company.

A recent Harvard Business Review study looked at a sample set of 187 Board members and found that 46% of those surveyed felt that a subset of Directors had an outsized influence on Board decisions, a dynamic referred to as a “Board within a Board.” While Boards should seek to arrive at consensus driven decision-making; the loudest voice isn’t always the wisest, nor the one that should be rallied around. This kind of feedback on a “Board within a Board” can be surfaced from individual Director evaluations and is important to share in these instances. Identifying these types of issues helps to ensure more conscientious engagement among Directors and can help promote an environment of genuine collaboration and respect among the Board while allowing for all voices to be heard.

1 “How Boards Should Evaluate Their Own Performance”, Harvard Business Review

This is not to suggest that poor performance or interpersonal conflicts, should they be identified, cannot be course-corrected. In fact, several of the study participants cited coaching as a crucial component of Director development, particularly early on in a Director’s tenure. In cases where a Director received consistent low performance feedback from their peers, they typically received one-on-one coaching from the Lead Independent Director (“LID”) /NCG Chair to address any improvement areas directly. Runways for performance turnaround are typically lengthy (up to two years) in order to allow low performers to get fully up to speed on the industry, business, and existing dynamics of the Board. The key is identifying any improvement areas early and ensuring a concerted effort to improve.

One NCG Chair identified a further benefit of gathering individual Director feedback particularly as it relates to positive feedback on Committee Chair performance. “If we get particularly strong feedback on a Committee Chair I like to share that feedback publicly with the committee. It fosters positive reinforcement and acknowledges the value and contributions of the position.”

Ultimately, a formal Director interview/assessment process can identify issues – particularly when it comes to interpersonal functioning of the Board, that are not as easily determined through a survey type format and should therefore be considered a valuable component of a thorough and rigorous assessment process.
Board Diversity

Now more than ever, diversity is a key consideration when evaluating the effectiveness and performance of a Board. Diverse and varied perspectives and experiences have proven to be the best approach to navigating a business through a world filled with uncertainty. Thus, Boards need to remain vigilant in ensuring that they are spending ample time and attention in populating themselves thoughtfully within this construct.

While relevant industry experience is always important on any Board, study participants cited relevant technical expertise as important additions to round-out and enable a truly effective Board. Areas like data and technology, ESG, cybersecurity, risk management, and audit experience are critical in today’s operating environment and many REIT Boards are desirous of technical experts that fall outside of real estate – an industry not typically known to be on the cutting edge when it comes to some of these functional skillsets.

Further, when it comes to adding active versus retired Directors, a balance is best practice. ISS guidelines typically limit active CEOs from sitting on more than one public Board and these top performers typically have their pick of “blue chip” Boards. Instead, recently retired executives share none of these restrictions. In addition, given the enhanced focus of Boards as compliance guardrails and fiduciaries, CFOs and individuals with robust audit experience are also typically very attractive candidates outside of CEOs to consider when thinking about skillset diversification.

This is all to suggest that the composition of a Board is vitally important and an area that should be addressed in a comprehensive manner during an assessment. One common approach is the creation of an “experience matrix” (example shown below) encompassing all the relevant experience areas that would be accretive on the Board. Directors are then asked to honestly assess their own experience levels within each subject area and the results are aggregated and compiled to identify any areas of significant overlap or noticeable gaps. This information is then utilized to strategically focus future recruiting efforts.

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Use of Third Parties

Boards are increasingly turning to third party facilitators to help them get more value out of their evaluation processes. According to a recent Ernst & Young study that looked at the proxy filings of Fortune 100 companies over the last several years, while only about one in five Boards used or considered using third parties in 2018, that number is now almost one in three. A majority of our study participants (62%) stated they have or would be open to using third-parties in their assessment process.

Third-parties can bring expertise and add value at several points of the evaluation process. They can be helpful when designing and facilitating evaluation questions and discussion topics and also in crafting action items designed to target areas of opportunity after feedback has been collected. Whereas survey questionnaires/assessments can sometimes be facilitated internally by the NCG, there are more mixed practices when it comes to facilitating a formal Director interview process. While some NCG Chairs/ LIDs are both willing and capable of leading these processes, others are not as comfortable, and they may seek to leverage third-party experts who specialize in leading individual Director evaluations.

In addition to the personal willingness and capabilities of internal facilitators, two schools of thought typically come into play in regards to the benefits of leveraging a third-party. The first is that Directors may be more inclined to be candid and open with their feedback when sharing with an independent and objective third-party versus delivering feedback to a peer. The second is that an experienced third-party facilitator can provide their own objective evaluation of the Board’s effectiveness as part of their feedback report. The latter may be particularly important during times of Board transition or crises when objective guidance can be a steadying influence. Ferguson Partners has seen this firsthand in our work with our clients – Directors who may be nervous to “rock the boat” in providing their perspectives to peers can be much more comfortable knowing their feedback will be provided anonymously and, likewise, Boards can receive additional comfort in understanding that oftentimes their challenges surfaced through these assessments are not unique and have been successfully addressed by others.

While these are important considerations, it should be noted that several of the Chairs we spoke with specifically cited discoverability as a potential concern for any sort of third-party facilitation. For those Boards that do leverage a third-party throughout the process, they believe the benefits and insights of including third-parties in their assessment process far outweigh the risk of any potential legal discoverability conflicts.

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1 EY Center for Board Matters 2020 Report

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### Used or considered using a 3rd party at least periodically to facilitate a Board evaluation

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<th>Year</th>
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*Source: EY Center for Board Matters*
Conclusion

The Board of Director assessment process is one that with appropriate care and attention can be a large value-add to Board functioning and, as a result, can result in greater protection of Company and Shareholder interests. Thus, it is no surprise that investors are increasingly taking note of these proceedings.

According to the Council of Institutional Investors, shareholders value “detailed disclosure” of the Board evaluation process when making voting decisions on Director nominations. As they put it, “Shareholders generally do not expect the Board to reveal the details of individual Director evaluations; rather, they want to understand the process by which the Board approaches the task of continually improving itself.” Indeed, a recent study of Fortune 100 companies found that 93% of proxy filers provided “at least some” disclosures about their Board evaluation process. 2

Here at Ferguson Partners, we have a dedicated track-record of helping our clients across all aspects of the evaluation process, from helping craft effective and insightful evaluation questions to conducting thoughtful Director feedback interviews and delivering that feedback in a constructive manner. With public disclosure of the Board evaluation process becoming commonplace, it’s time to take stock of the evaluation processes on your Board to ensure that you are instituting the best governance practices and getting the most out of your assessment process.

2 “Effective Board Evaluation,” Harvard Law School Forum on Corporate Governance; Ernst & Young
Enhanced performance expectations, challenging economic conditions, and a more stringent regulatory environment have all served to increase the scrutiny on corporate Board performance in recent years. Rigorous Board and Director self-assessment practices are now widely considered critical tools to ensuring optimal Board functioning, and deserving of real time and attention in the boardroom.

Ferguson Partners spoke with nine Nominating and Corporate Governance Committee (“NCG”) Chairs, currently serving on the Boards of prominent REITs, to understand what they believe are the keys to unlocking tangible value from the Board and Director assessment process.

David J. Contis  
Nominating and Corporate Governance Chair  
Equity Lifestyle Properties Inc. (NYSE: ELS)

Mary Hogan Preusse  
Lead Independent Director and Nominating and Corporate Governance Chair  
Kimco Realty (NYSE: KIM)

Christopher P. Marr  
Nominating and Corporate Governance Chair  
Stag Industrial Inc. (NYSE: STAG)

Reginald H. Gilyard  
Nominating and Corporate Governance Chair  
Realty Income Corporation (NYSE: O)

Elizabeth I. Holland  
Nominating and Corporate Governance Chair  
Federal Realty Investment Trust (NYSE: FRT)

Sharon M. Oster  
Nominating and Corporate Governance Chair  
Welltower (NYSE: WELL)

David B. Henry  
Nominating and Corporate Governance Chair  
VEREIT Inc. (NYSE: VER)

Matthew J. Lustig  
Nominating and Corporate Governance Chair  
Boston Properties (NYSE: BXP)

E. Scott Urdang  
Nominating and Corporate Governance Chair  
Gaming and Leisure Properties Inc. (NASDAQ: GLPI)