Transforming board evaluations — the board maturity model

By James Beck, Managing Director, and Mark Watson, Senior Advisor, Effective Governance

- Existing quantitative and qualitative board assessment processes are useful but don't factor in the position of an organisation in its lifecycle
- Board maturity model benchmarks stages of an organisation's board's progress against various key criteria
- Provides a pathway to improved performance to the mutually agreed future stages with each stage providing goals to which the board can aspire

Boards are increasingly using board evaluations to provide them with an objective assessment of how to enhance the performance of the board, chair and individual directors. There are many different ways of conducting such evaluations and it can be quite challenging for the board to determine which method or methods it should adopt.

The board needs to be confident that all the key issues have been investigated and then consensus has to be obtained with regard to how to address those areas identified for improvement. A further challenge for the board is to determine how it can translate the findings of the evaluation into a comprehensive action plan for change.

This article proposes a transformational tool — the board maturity model — to address these challenges. It is ideally suited to evaluating board performance because it provides an integrated framework in which to assess a board's degree of governance maturity and to benchmark its performance against other boards. Moreover, it is simple to grasp but robust enough for busy board members to make sound decisions.

Why are board evaluations important?

In the past ten years, formal board evaluations have been increasingly used as a method of assessing the performance of boards of Australian organisations. The impetus for evaluating board performance can be attributed in part to increasing regulatory prescription. For example, Recommendation 2.5 of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* states that 'Companies should disclose the process for elevating the performance of the board, its committees and individual directors'. Also, the Australian Prudential Regulation Authority (APRA) *Prudential Standard APS 510 — Governance*, for example, states that the board 'of a regulated institution must have procedures for assessing, at least annually, the Board's performance relative to its objectives'.[1] As a result, there has been rapid adoption of board evaluations in recent years by all listed companies and entities regulated by APRA.

An equally compelling reason for boards to evaluate their performance is that they are teams and, like all teams, they can benefit from feedback.[2] Indeed, there is growing evidence that factors such as board working style, the ability of directors to work together and the competency of directors are not only just as important as structural factors relating to board performance, but are critical if boards are to function at a high level.[3] Importantly, board evaluations allow the board set the 'tone from the top' by sending a strong message to stakeholders that the board values a performance culture. This helps to explain why boards of non-listed companies, not-for-profit and member-based organisations have also embraced board evaluations.

Properly conducted board evaluations help establish the individual and collective responsibilities of directors and identify where the board and indeed individual directors need to enhance their performance. Moreover, the benefits can permeate throughout the entire organisation. For example, in terms of accountability, a board evaluation can focus the board's attention on its duties to its stakeholders. It can also ensure that individual directors understand their duties and responsibilities. From an organisational perspective, the evaluation can assist in clarifying the board's delegations to management resulting in improved organisational governance practices.

Existing board evaluation practices

What are they?

In broad terms, board evaluations can employ qualitative techniques, quantitative techniques, or a combination of the two, to gather data.

Qualitative techniques employ questions relating to 'what', 'how', 'why', 'where' and 'when'. They are particularly useful when the board wants to determine the underlying causes of governance problems or to gain insights into how to resolve them. The most commonly used qualitative technique involves interviewing board members either as a group or individually. Interviews provide an opportunity to collect rich and complex data but require an experienced interviewer and can be very resource intensive in terms of designing lines of questioning and subsequent analysis of directors' responses. A second technique is to review key board documentation such as the board charter and board papers and to compare them with leading practice board documentation. Another technique consists of an impartial observer observing one or more board meetings. This can be useful in determining how the board members actually function in their natural environment but it is resource intensive in terms of data collection.

Quantitative research methods use questions asking 'how much' and provide specific and measurable responses. The most common method of gathering quantitative data is by means of surveys. They allow responses by individual board members to be compared and contrasted with each other in a way that can be readily communicated to the board and for the responses to be compared over time. However, surveys are attitudinal instruments and measure individuals' subjective responses to questions and are therefore subject to responder bias.

Each of the above techniques has its strengths and weaknesses and there is no single best way to conduct a board evaluation. For example, if board performance is only assessed by means of a survey, the results may be biased because they are based on the perceptions of individual board members who may be wearing rose-coloured glasses. In this case, a review of governance documentation may highlight issues that would have otherwise have remained hidden. Therefore, a combination of techniques may better reflect how well the board is performing. In other words: measure (at least) twice, cut once!

The limits to existing evaluation techniques

The above qualitative and quantitative techniques enable the board to assess its performance at any given point in time with respect to its roles such as strategy and planning, risk management, compliance, decision-making and governance. They are also very useful in providing a snapshot of board competencies, structures and behaviours.

Such snapshots are undoubtedly useful in that they provide feedback to the board on areas of governance that require improvement. However, they do not take into account where the organisation sits in its lifecycle and what can reasonably be expected of it from a governance viewpoint given its level of maturity. Is it a start-up company, for example, where the board and management may be doing whatever is necessary just to stay in existence? Another problem with snapshots is that, while they tell the board its current position, it can be difficult to tell in what direction the board should be heading. If there are a large number of areas where the board needs to improve, it can be overwhelming knowing where to start.

Also, it can be difficult to benchmark a board's performance objectively against other boards using the traditional tools for measuring board effectiveness. Surveys, for example, suffer from directors' subjective biases and, while comparisons can be made with other organisations using qualitative techniques, it is nevertheless challenging to do so in a holistic and structured way.

These observations raise an important issue in board evaluations: is it possible to benchmark boards? Some commercial organisations offer benchmarking services where, by using a common questionnaire over multiple boards, comparisons can be made as to how one board rates relative to other boards that have participated in the same survey. However, this process is quite misleading.

First, the rating of these boards is a function of the level of insight of the directors — high scores do not necessarily represent high performance. Because of this insight, for boards to be benchmarked, directors would need to be common across the comparable boards. Second, board performance can be arrived at by different means and is contingent upon many factors including the organisation's operating environment and industry — a point that is ignored where a score is simply contrasted with a sample of other scores.

The board maturity model

From our experience at Effective Governance, having reviewed over 350 boards in the last decade, we

have identified the need for a practical approach, which allows boards to compare their performance with boards at a similar stage of maturity and which provides a road map for improvement. A maturity model offers such an approach.

A maturity model is a two-dimensional structured approach for describing the principal characteristics of an organisation or a project at various stages of maturity. One of the earliest maturity models is Philip Crosby's quality management maturity grid.[4] In Crosby's model, the typical behaviour displayed by an organisation for six quality measurement categories is displayed in one dimension. The second dimension displays various stages or levels of 'maturity'.

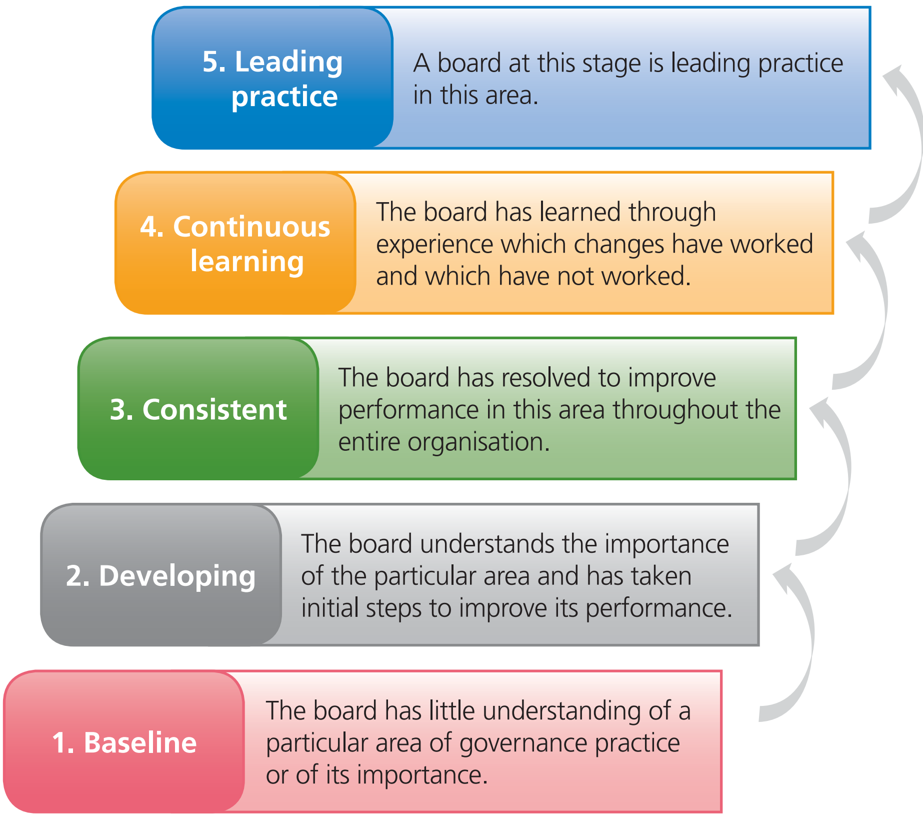
A powerful feature of such models is that it is quite easy to assess an organisation's current level of performance by matching it with one of the typical behaviours in a grid. An equally powerful feature is that it is very easy to see what the organisation needs to do next in order to improve its performance. It also allows an organisation to benchmark its level of maturity against other organisations because those making the assessments have a common understanding of what constitutes a particular level of performance against each measurement category.

Maturity models are now used in a range of disciplines including software acquisition, software engineering, project management and change management. The Effective Governance board maturity model draws its inspiration from Philip Crosby's quality management maturity grid.

The two dimensions of the board maturity model

The first dimension of the board maturity model consists of a number of stages ranging from an initial baseline stage progressing through to an optimal stage where leading practices are followed or established. Progressing from one stage to the next is a little like obtaining different coloured belts in the martial arts in that each stage builds upon and incorporates the requirements of the preceding stages. In the case of board governance, the stages are depicted in Figure 1.

Figure 1: Stages of board maturity

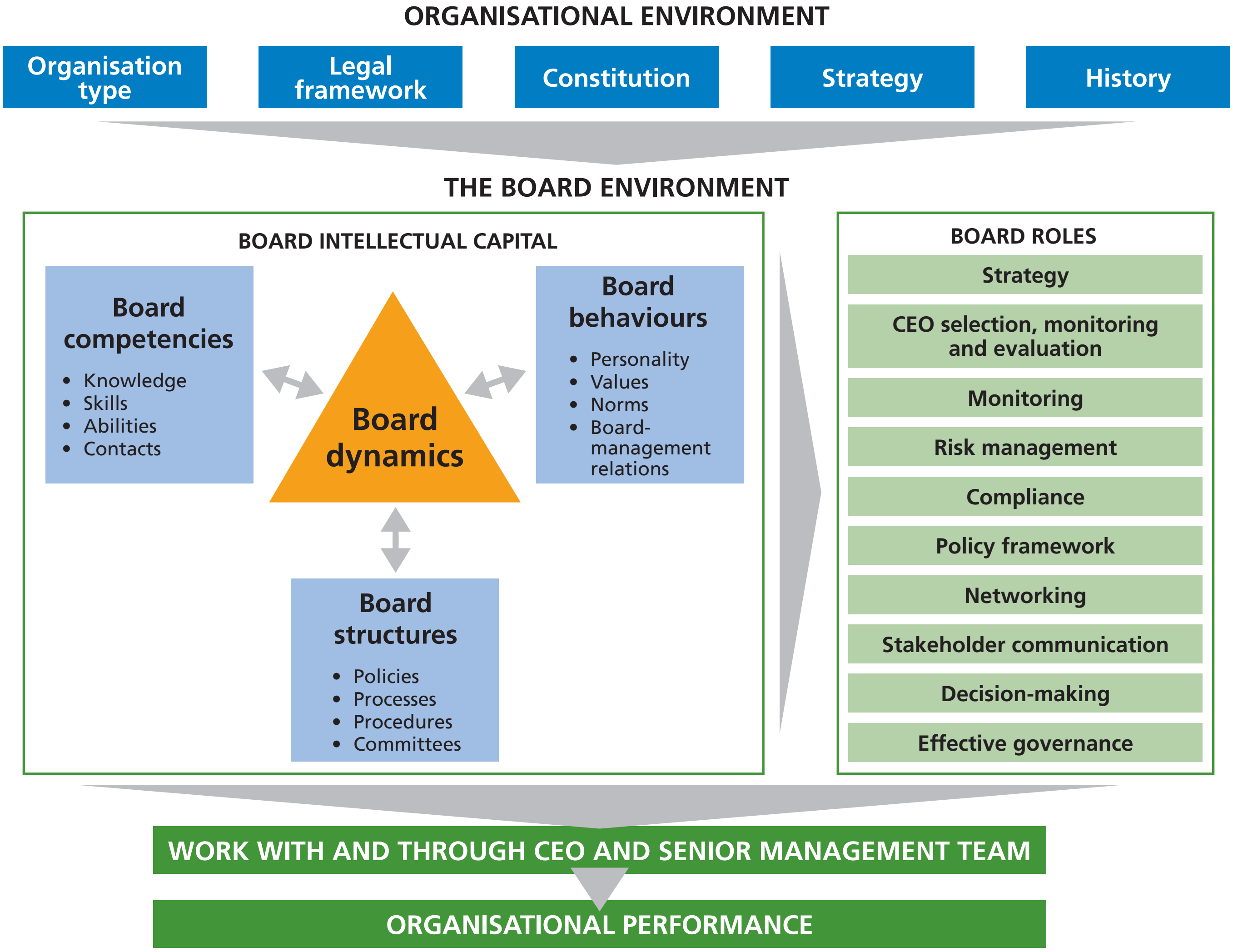


The second dimension of a maturity model consists of the key areas which must be addressed within each stage before the organisation can move to the next stage. At Effective Governance, we use our high-performance board model (See Figure 2), developed by our colleagues Emeritus Professor Geoffrey Kiel and Associate Professor Gavin Nicholson, as the framework for determining the key areas that must be evaluated to move from one stage to the next. The organisational environment component of the high-performance board model takes into account where the organisation sits in its lifecycle and what can be expected of the organisation at any given stage of maturity.

The 13 key areas for evaluation are drawn from the board environment in Figure 2 and are:

- strategy
- selection, monitoring and evaluation of a chief executive (CEO)
- monitoring
- risk management
- compliance
- policy framework
- networking
- stakeholder communication
- decision-making
- effective governance
- board competencies
- board behaviours and
- board structures.

Figure 2: Effective Governance high-performance board model



A worked example — CEO evaluation

The next step is to bring the two dimensions together and to define the typical behaviours for each key area versus stage of maturity. This can be illustrated by considering the key area of CEO evaluation as shown in Table 1.

Using the board maturity model, it becomes quite straightforward for a board to determine not only its current stage of maturity in this area but also to gain consensus on the desired target stage. For example, a board that does not evaluate the performance of the CEO and does not address concerns about the CEO's performance, and where little documentation is in place to conduct

Table 1: Effective Governance board maturity model — CEO evaluation

Stage	1 ***Baseline***	2 ***Developing***	3 ***Consistent***	4 ***Continuous learning***	5 ***Leading practice***
Key area: CEO evaluation	CEO evaluation does not occur	An informal CEO evaluation occurs annually There are no mid-term or periodic reviews of the CEO's progress	A formal CEO evaluation occurs annually There are no mid-term or periodic reviews of the CEO's progress	A formal CEO evaluation occurs annually Mid-term and periodic reviews of the CEO's progress are being trialled	A formal CEO evaluation occurs annually Mid-term and periodic reviews of the CEO's progress take place
	Performance concerns are not addressed by the board	Unsatisfactory performance is addressed by the board There is no formal annual performance exchange between the CEO and the board	Unsatisfactory performance is addressed by the board An informal annual performance exchange occurs between the CEO and the remuneration committee	Unsatisfactory performance is addressed by the board A formal annual performance exchange between the CEO and the full board is being trialled	Unsatisfactory performance is addressed by the board A formal annual performance exchange occurs between the CEO and the full board The chair provides regular informal feedback to the CEO
	Most of the following documents do not exist: • CEO evaluation policy • CEO evaluation procedures • CEO's position description • CEO's performance agreement and • organisational values	Some CEO evaluation policies and procedures are documented but are out of date	Existing CEO evaluation policies and procedures are being updated and missing policies and procedures are in course of development	An updated suite of CEO evaluation policies and procedures is being trialled	CEO evaluation policies and procedures are fully documented, updated as required and reviewed at least annually

an evaluation, would be situated at the 'baseline' stage. In order to progress to the next stage, the board would need to remedy these shortfalls.

It is worth noting that boards are unlikely to find themselves in the same state in each of the 13 key areas and across all five stages. Therefore, as a first step, the board needs to give priority to those areas that are lagging behind the others. It is, of course, also possible for a board to straddle two stages in any particular area. For example, a board could conduct informal annual CEO evaluations (Stage 2), but the evaluation could be compromised if there is no formal CEO performance agreement in place (Stage 1). In this case, the board may be situated between the two stages and would need to comprehensively address any shortcomings in Stage 1 before it could advance to Stage 2.

Furthermore, rather than just providing a snapshot of the board's performance, the board maturity model also provides a pathway to improved performance to the mutually agreed future stages with each stage providing goals to which the board can aspire. Another powerful feature of this approach is that boards can benchmark themselves against leading practice boards based on a common understanding of each stage of maturity.

After the board has determined its stage of maturity in any particular area, it needs to agree on what should be done differently. This is where the maturity model proves invaluable because the board can readily measure the gap between its current state of maturity and its desired state with a clear picture of what it is seeking to achieve. This, in turn, assists the board to develop an adequately resourced top down action plan to move to the next stage.

The great advantage of the board maturity model is that it is simple to grasp but robust enough for busy board members to make sound decisions. Having conducted extensive research on currently deployed board evaluation techniques, we believe that Effective Governance is the first to implement this transformational approach in Australia.

The next steps

What happens after the board evaluation report is delivered and the findings are discussed? Does the board forget about the outcomes of its performance assessment until the next review? Unfortunately, that is often the case. Directors' attention moves to other issues and any impetus for change is lost. Worse still, where recommendations for improvement are made, but not implemented, directors will feel the evaluation has been a waste of their valuable time.

Therefore, it is critical that any agreed actions that come out of an evaluation are implemented and monitored if the board is to move to the next stage of maturity. Boards can include a review of action steps as an agenda item to be tracked at each meeting. Milestones can be established for the achievement of the action plans and progress reviewed until all agreed changes have been implemented. We would recommend these activities be documented in a 'board road map'.

Documenting what is to be done, and is being done, is another important step in improving board performance. The road map is a good way to see the impact of an evaluation from the outset; for example, 'quick wins' or 'easy fixes' from the process may include a revised agenda or restructured board papers — these can then be crossed off the list of activities. Longer-term outcomes might necessitate a board paper prepared by a committee, for example, recommending a new process or policy to the board for approval. The road map will set out the key steps the board must take to ensure the process is one of continuing improvement.

Conclusion

The board maturity model provides an integrated framework for assessing the board's current stage of maturity and determining what it needs to do next to reach the next stage of board maturity.

The board can easily determine its stage of maturity in all key governance areas by matching its performance with the

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typical behaviours in the board maturity model. The model reduces the possibility of subjective bias because each key area versus stage of maturity is defined by one or more typical behaviours. Benchmarking now becomes possible and reliable because assessments are based on a common understanding by directors of typical board behaviours for each key governance area. It is ideal for busy board members who need to quickly assess their board's performance because it is simple to grasp but robust enough to make sound decisions.

An equally powerful feature of the board maturity model is that, by its very nature, it points the board in the direction that it needs to take to progress to the next stage of maturity. The board road map can then be used to detail the specific activities required for the board to move to that stage and it can be reviewed at each board meeting to track progress towards reaching the next stage. As a result, progression to the next stage of maturity remains in the forefront of each director's mind and continuous improvement becomes part of the board's culture.

In reviewing the findings of the many board evaluations conducted by Effective Governance, we found that benchmarking against other boards was very difficult when comparing boards at different levels of maturity. We believe the board maturity model is an innovative solution to the issues raised in this paper with respect to current benchmarking practices and provides a different approach to board assessment.

James Beck can be contacted by email at James.Beck@effectivegovernance.com.au.

Mark Watson can be contacted by email at Mark.Watson@effectivegovernance.com au. Both can be contacted on (07) 3510 8111.

Notes

1 para [82]
2 Nicholson G, Kiel G and Tunny JA, Forthcoming, 'Board evaluations: Contemporary thinking and practice', in Branson DM and Clarke T (eds), *The Sage Handbook of Corporate Governance*, London: SAGE Publications Inc
3 ibid
4 Crosby PB, 1980, *Quality is Free: The Art of Making Quality Certain*, Mentor