CEO Evaluation

“The affairs of an organization must be managed under the direction of the Board. This does not mean, however, that the Board manages the organization on a day-to-day basis, since most, if not all management functions have been delegated to the CEO. The Board, however, retains the ultimate direction and control over the activities of the CEO and where appropriate, others on the senior management team.”

The statement above is a sample of what typically is contained in the by-laws for governing boards of many organizations. Fundamentally, it says that the board sets broad direction for the corporation with the CEO along with his/her staff, who, acting as agents, carry out these directives. Essentially, the CEO is the single linking pin, connecting the organization’s human, financial and physical assets back to the Board.

Thus, there is no more important duty of a board than the hiring of the right CEO. Once, the hiring decision has been made, another critical duty is to, at least annually, provide a thorough, accurate and constructive performance evaluation of the CEO. This article explores emerging changes in the oversight role of boards and how these changes are likely to alter the manner and substance of the CEO performance evaluation and the process used to conduct such a review.

The answer, my friend, is blowing in the wind

As the lyrical verse from Bob Dylan’s famous song implies, there is a lot of wind out there being posited by scholars and pundits alike who are commenting on the impact that Sarbanes/Oxley has had and how this regulation will continue to influence the manner in which governing boards are to carry out their fiduciary duties. As Benjamin Franklin noted, “Nothing in life is certain, except death and taxes”. Adding to Franklin’s aphorism, we should anticipate another statement of certainty, that being with the passage of any major piece of legislation or regulation, one should anticipate efforts, be they case law or otherwise, to redefine and broaden its applicability. We should expect many “sons and daughters” of Sarbanes to emerge in the not-too-distant future to further refine and redefine what has been a very broad and unregulated area, that is, the behavior of a governing body to carry out its oversight function.

Thus, boards are now required to ensure that the criteria used to evaluate the Chief Executive incorporate measures that will fulfill the spirit of Sarbanes-Oxley, but more importantly, act as a meaningful resource for the CEO and the senior team in better understanding board governance prerogatives.

What should the CEO and the Board each receive from its annual review, and how will changes in governance influence this relationship? Essentially, the new law seeks to bring about two principle changes to the board: 1) greater independence and 2) stronger influence over corporate affairs. It is in managing this new dynamic that should be the locus of Board and CEO interaction.The foundation of this relationship should be based on several key questions a Board should continually ask itself: Did we make the right hiring decision? If we did, how can we best communicate this to ensure continued success? If we are wavering off course, what steps and controls do we want to build that can redirect us back on tract? Have we provided clarity to know if a “make or break” decision needs to be made? If we didn’t make a good decision, how can we avoid making a mistake next time?

Similarly, the CEO and the senior team will need to know the extent to which the board has confidence in both the CEO and his/her key staff. If not, how best can the Board provide clear and unambiguous direction to get things back on solid footing.

Now, when we consider the fundamental changes brought about by Sarbanes/Oxley with its emphasis on greater board independence and stronger control over certain areas of the board/management relationship, a new set of criteria emerges that highlight the need to focus on how this interdependent relationship is to be managed.

To facilitate these changes, there are three fundamental things that need to happen well in advance of the review process. These are:

1. Gain clarity within the board and communicate to the CEO how the Board views its governance role and its expectant relationships with senior management.
2. Be specific as to the role of the board and how management can best support how the board is to carry out its governance mission.
3. Define how best to provide feedback to the CEO and senior team to ensure a mutual understanding agreement.

Planning for the review:

In conducting this review, care must be taken to ensure that the full scope of the CEO’s position’s duties and responsibilities are reviewed in the full context of the review period. The evaluation should not be based upon a single problem, mistake or achievement but rather, a broad look at the CEO’s contribution to the organization and its outcomes.

Who Should Be Involved?

The Board Chair oversees the assessment process and directs the gathering of input from other Board members. For staff support, the skills often found in a senior Human Resources executive may serve as an advisor and facilitator to the review process. Some organizations have internal HR talent who can step up to the plate and marshal this process. If the right type of internal talent is not available, the Board may want to contract with an external HR consulting organization with expertise in executive review, assessments and succession planning.

Depending upon the organization, either the Compensation or the Executive Committee usually reviews input from other Board members, monitors other related data and recommends appropriate evaluations to the Board Chair.Steps to Get Organized For The Review

1. The Chief Human Resource Officer notifies the Board Chair when it is time to begin planning for the CEO's formal review. It is recommended that a preliminary meeting be held with the Compensation/Executive Committee (hereafter referred to as the "review committee") to outline the performance review process and establish a specific date for the performance review meeting.
2. The CEO needs to be told of the scheduled review date as soon as possible. The CEO should prepare several items in advance of the meeting, including:

- An overall "state of the organization" report (in writing);
- Highlights of major accomplishments during the review period;
- Major objectives achieved, or not achieved, and why;
- A presentation of a Management Succession (Continuity) Report (more about this in the following article on "succession planning");
- A self-assessment on "Board Relationship Management "; and,
- Other relevant information.

3. The Board should be informed about the performance review process and each member asked to complete a review form that should be designed to give clarity to issues and easy for Board members to fill out.
4. All Board members return completed review forms to the Board Chair who reviews them for completeness, the need to clarify comments, etc. (As an option, the Board Chair may also wish to gain input from direct reports to the CEO particularly as it relates to organization culture and management practices. A third party HR consultant is often best to gather this information to encourage candid responses and anonymity.)

Conducting The Review With The Review Committee

The role of the review committee is to provide an in-depth and broad-based discussion of performance. It is not necessary to resolve specific numerical ratings at this meeting, if they are used. The Board Chair will use this input for arriving at a final assessment of performance. With this in mind, the following steps are suggested:

1. The review committee meets with the CEO to conduct the review. The recommended process for the day of the meeting is:

1. Brief executive session to review meeting agenda/plan
2. The CEO presents:

- An overall “state of the organization” report;
- Highlights of major accomplishments;
- Achievement of objectives;
- Management Succession review; and,
- Discussion of “Board Relationship Management”.

3. The review committee moves into a question and answer period before the CEO is released from the meeting. The review committee discusses performance and suggestions for personal and professional development and questions the CEO on other key management roles and the talent available.
4. The Board Chair dismisses the CEO from the meeting to caucus with the committee to summarize highlights of the Committee’s review, determine the final overall rating and determine developmental action plans.
5. A follow-up meeting with the CEO and the Board Chair should occur as soon as possible – -preferably on the same day as the Review Committee’s meeting. At this meeting, a verbal presentation and discussion of the outcomes of the review will be discussed with the CEO prior to formal documentation of the review. This gives the CEO time to formulate his/her response on how best to move forward with any recommended actions.

White Paper

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