Board Evaluation - Mutual Admiration or Thoughtful Reflection?

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KPMG in Malaysia

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Foreword by the Managing Partner

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The late 35th President of the United States, John F. Kennedy, once said "change is the law of life and those who look only to the past or present are certain to miss the future". The seismic shifts that we are currently witnessing in the global marketplace represent an apt testament to the expression of wisdom and foresight by John F. Kennedy. Collision of forces such as digitisation, geopolitical shake-ups and macroeconomic policy adjustment is creating a continued motion for corporations to disrupt the marketplace or risk being disrupted and becoming antiquated!

As disruption becomes firmly embedded in the lexicon of corporations, a recurring question percolating in boardrooms and amongst shareholders as well as other stakeholders, is "how do boards govern in a disrupted world?" Uniquely positioned at the helm of the company, directors are certainly expected to provide long term strategic direction, entrepreneurial leadership and effective oversight – all of which call for responsible yet responsive stewardship.

Against this backdrop, it is no surprise to see board members constantly challenging themselves to raise their game. To this end, a board evaluation exercise arms directors with a valuable platform for introspection and an opportunity to change the status quo. It allows the board to self-reflect and ascertain if the board has a good mix of individuals who possess the right skills, experience and judgment to govern effectively.

Since board evaluation was first introduced to corporate Malaysia more than a decade ago, this practice has certainly evolved with a growing recognition that the business case for it is clear and compelling. In fact, many directors have shared anecdotes with us that after they concluded board evaluations, frictions during their meetings were reduced, their boardroom information architecture improved, and they have defused ambiguities between their roles and that of management as well as paid more attention to long-term corporate strategy.

In this regard, the introduction of regulatory enumerations which calls for periodic externally facilitated evaluation is certainly a welcome development in Malaysia. An externally facilitated board evaluation provides a new lens to view the board's capabilities, processes and dynamics dispassionately with the objective of unearthing latent improvement considerations.

To recapitulate, as companies continue to negotiate their relationship with change, it is important to build processes that can help companies to tap the accumulated expertise and strategic potential of the board. Winning boards will be those that work in the spirit of continuous improvement and an effective board evaluation exercise certainly represents a means towards this end.

KPMG in Malaysia has been curating materials on corporate governance regularly and it is our hope that this seminal publication on board evaluation will be useful to those with a keen interest in governance, corporate world and beyond. This publication considers how boards can review their performance in a value-adding manner with a focus on the evolution of board evaluations over the recent years.

Datuk Johan Idris

Managing Partner

KPMG in Malaysia

Foreword by the Head of Governance & Sustainability

The axioms - "exercise of mutual admiration", "mutual appreciation huddle", "self-serving evaluation", "back scratching appraisal" and "navel gazing" have been commonly bandied around to describe board evaluations that are reduced to one that is benign, perfunctory and non-value adding. As tellingly expressed by these highbrow axioms, selected companies opt to regard board evaluation as a "necessary evil" to assuage the insatiable needs of regulators and the dogged insistence of shareholders in demanding a view on the efficacy of boards. Those in the inner sanctum of boardroom activities can certainly attest to this and in fact, many would vividly chronicle anecdotes of flagrant behaviour amongst directors in this regard. As satirical as it may seem, selected directors have been seen to only provide a single input rating for a particular questionnaire item in the board evaluation instrument with a cheeky caveat that the same would apply to the remaining questions and their peers (i.e. a practice colloquially known as ditto!).

Whilst the sobering state mentioned above is true and applies to a cross section of companies in Malaysia, it does not represent a microcosm of corporate Malaysia. In an age whereby directors are constantly challenged to raise their game, many enlightened companies have come to realise that board evaluation is an opportunity to understand the pathology of the board and board committees whilst assessing if individual directors are able to discharge the duties in a delectable (and not derelict) manner. Carefully designed and thoughtfully conducted board evaluation could certainly benefit boards by allowing each director to surface issues of concern, recalibrate focus and agree upon priorities for improvement. The importance of building processes that can help companies to tap the accumulated expertise and strategic potential of the board cannot be overemphasised.

Over the years, we have witnessed an evolution in the process of evaluation with reinforcements on several fronts. A renowned financial institution in Malaysia is known to optimise its board evaluation process by having a focus on key roles of directors in the boardroom, incorporating "what-if" questions in the instruments, obtaining input from management on the efficacy of the board (an exercise dubbed as "360 degrees" evaluation), developing report cards for individual directors and co-ordinating the evaluation process across the subsidiaries. Such an extensive exercise clearly serves as a testament to the efforts that some companies are willing to undertake so as to generate a wholesome outcome.

Companies that have optimised the board evaluation process are often well-placed to bring about tangible change, leading to superior governance and organisational outcomes. It is not unusual for directors, having concluded board evaluations to share anecdotes of the benefits that entail such as frictions during their meetings were reduced, their boardroom information architecture improved, and they have defused ambiguities between their roles and that of management as well as devoted increased attention and articulation to long-term corporate strategy.

Of course, the proliferation of technology characterised by modalities such as cloud computing, machine learning and data analytics offers plenty of opportunities to seamlessly enrich the board evaluation process. A few keystrokes across a well-designed and suitably customised board evaluation tool could enable boards to amongst others to undertake a diagnosis of the time spent on boardroom activities, identify trends and even assess how it is faring vis-à-vis boards of other companies through in-built benchmarking and thematic scanning.

On a related note, an externally facilitated board evaluation represents a key game changer that can help to bring about transformational change for boards. It is indeed heartening to note this externally facilitated practice is quickly gaining traction in Malaysia. Based on disclosures released by listed issuers in 2018, it was gathered that over 80% of the Large Companies[1] in Malaysia have conducted externally facilitated board evaluations or have put in place crystalised plans to undertake one in the forthcoming years with outsourced secretarial firms, search firms, professional associations and professional services firm being the parties that lend their expertise. Whilst it is undeniable that regulatory impetus is driving the demand for externally facilitated board evaluations, the value proposition that emanates from such an exercise cannot be debunked. Succinctly put, externally facilitated evaluation not only brings rigour as well as fresh perspectives and objectivity to the process but it can also help to draw benchmarks on better practices from other boards, both across the region and globe.

In summary, board evaluation opens a window of opportunity for self-reflection and serves as a catalyst for driving changes in companies. In the famous and evergreen words of Michael Jackson that reverberated the entertainment arena, "I am starting with the man in the mirror, I am asking him to change his ways".

Kasturi Nathan

Head of Governance & Sustainability

KPMG in Malaysia

1 Companies with market capitalisation greater than RM 2 billion and above or FTSE 100 Bursa Malaysia companies

About this publication

This Report on Board Evaluation ("Report") explores the thinking, approaches and practices associated with the conduct of a board evaluation exercise. The data underlying this Report is primarily procured through disclosures contained in the most recent Annual Reports and Corporate Governance Reports of listed issuers, whilst the narratives have been developed based on the considerations gathered from anecdotal observations as well as secondary research sources.

KPMG's effort in producing this publication is part of its wider agenda to further good corporate governance in Malaysia. KPMG also supports the events pertaining to audit committees, where topical issues in relation to corporate governance are deliberated with board and industry leaders and chairmen of board and audit committees from leading companies.

Whilst every care has been taken to ensure accuracy of the information produced in the Report, KPMG does not warrant the veracity of the information and accordingly. KPMG does not assume responsibility or liability for any reliance on this Report.

The information included in this Report is limited to the disclosures made available by listed issuers and KPMG's internal repository as gathered from interactions with listed issuers. Where information contained in the disclosures of listed issuers was ambiguous or unavailable, we have not used such information so as to preserve the accuracy of the Report. In addition, no deduction or extrapolation should be made to link any companies to the anecdotes presented in this Report.

Words importing one gender include the other gender, as applicable. Words used to describe to an entity (e.g. company, listed issuer) are premised on grounds of their application in the regulatory context.

We also highlight that the Report outlines related practices carried out by listed issuers based on the perceived value of such information to companies. Nevertheless, we emphasise that care should be taken in considering the information presented in the Report, as it is not KPMG's intent to promote a "one-size fits all" model to board evaluation.

About KPMG's Governance & Sustainability ("G&S")

Datuk Johan Idris
Managing Partner
KPMG in Malaysia

Chan Siew Mei
Head of Advisory
KPMG in Malaysia

Kasturi Nathan
Head of Governance & Sustainability
KPMG in Malaysia

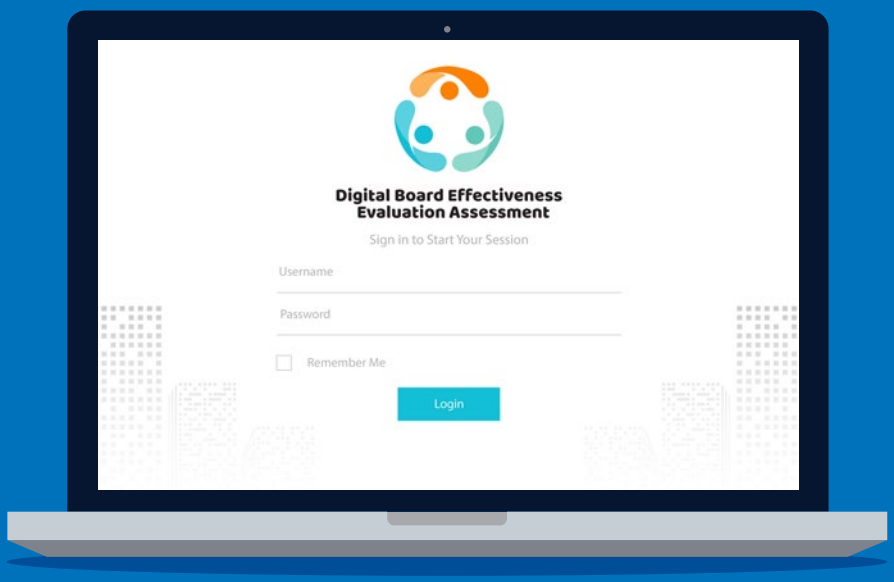
KPMG's G&S team is made up of multidisciplinary governance professionals who can assist boards and board committees to:

- Benchmark and improve current governance frameworks against better practices
- Undertake board, board committees and individual directors' evaluations that identify areas of strengths and improvement opportunities in areas such as risk and strategy, succession planning, boardroom independence and stakeholder engagement
- Undertake a remuneration review to help boards determine the competitiveness and risk alignment of existing structure to attract, retain and motivate the right talent on boards and senior management
- Design tailored board training around risk, strategy and governance to assist boards to meet their fiduciary duties
- Facilitate the construction of boards' "suit of armour", including board documents, policies and processes that underpin a robust governance framework of risk management, strategy formulation and monitoring

Krishman Varges PV John
Manager – Governance & Sustainability
KPMG in Malaysia

Krishman, a senior member of the G&S consulting practice of KPMG in Malaysia specialises in carrying out board effectiveness evaluation and board advisory services including advising clients on corporate governance matters, such as structuring of boards, policies and procedures and remuneration issues.

Introducing the KPMG Board Evaluation Software



Ease of access

Confidentiality and security

Data storage and analytics

Instant results infrastructure

Revolutionaries, futurists and restless geniuses have facilitated the development of exponentially advancing technologies by repurposing the concepts, discoveries and breakthroughs of their predecessors. Against this backdrop of dizzying innovation, KPMG has sought to continue the generation of positive cycles and loops of advancement in the realm of corporate governance by exploring how technology can further enhance board effectiveness.

More specifically and germane to this publication, KPMG has the pleasure of introducing a software that can enrich the board evaluation process. By way of a quick teaser, the board evaluation software, powered by KPMG brings to bear the following features:

User-friendly interface

Personalised features, status progress indicator and export functionalities

Customised questionnaires

Tailored questions based on first hand boardroom and industry insights

Built-in checks

Detection of anomalies, mandatory fields and minimum response time

Data analytics

Score dashboard, trend analysis and repository benchmarking

Automated reporting

Thematic write-ups based on responses gathered

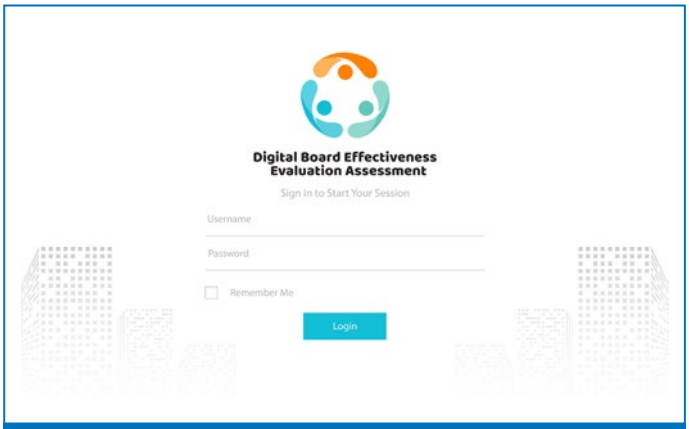
Respondent Confidentiality

Rigorous network security that protects any user information or client data

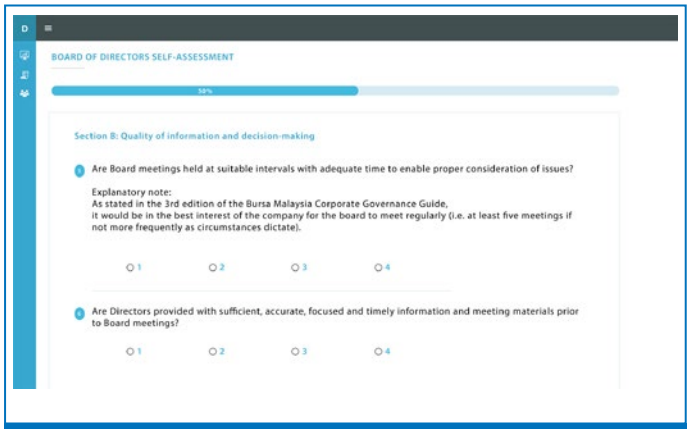
Enhanced security

Unique credentials and clear demarcation between administrator and respondents (board members)

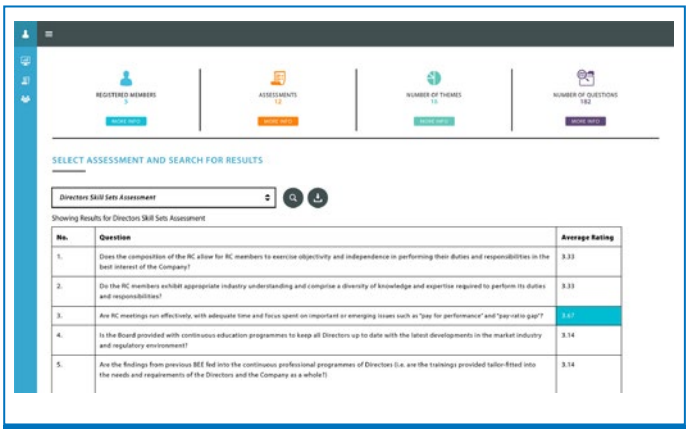
The mechanics of the electronic board evaluation system, powered by the KPMG software can be laconically represented as below:



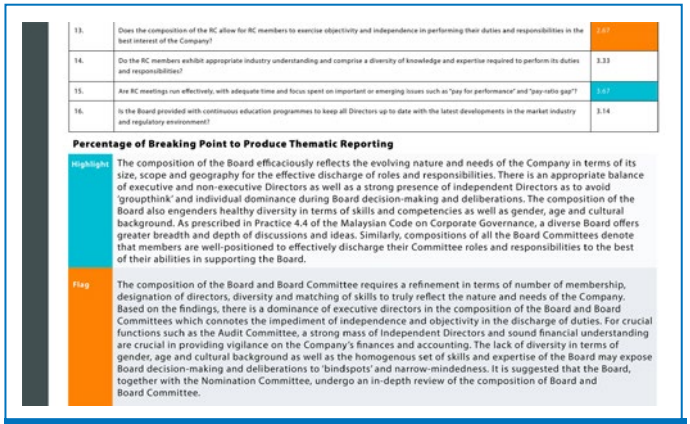
Step 1: **Enters credentials and logs in**



Step 2: **Completes assessment and questionnaires**



Step 3: **Evaluation finishes**



Step 4: **Findings and analytics report are generated**

Source: KPMG Board Evaluation Software

Legend: Administrator (Company Secretary) User (Director)

All in all, this software can serve to iron out the wrinkles that have been omnipresent in traditional board evaluation process - some of which include the failure to complete assessment instruments due to time constraints, provision of uniform rating for all questions in the instruments and lack of synthesis in drawing up the results.

With time and trial, the system is expected to be enhanced as we consider feedback from the marketplace and seek to incorporate advanced features. Plans are already underway to create a data repository benchmarking exercise and peer analysis vis-à-vis listed issuers across the ASEAN region. To this end, KPMG would welcome any input that would help to unleash the utmost potential of this system.

The numbers crunched

Where can enumerations on board effectiveness evaluation be found?

- Rule/paragraph 15.08A of ACE Market/ Main Market Listing Requirements of Bursa Malaysia Securities Berhad
- Standard 13.1 and Guidance 13.2 of Bank Negara Malaysia's Policy Document on Corporate Governance
- Practice 5.1 of Malaysian Code on Corporate Governance ("MCCG")

Practice 5.1 of MCCG

The board should undertake a formal and objective annual evaluation to determine the effectiveness of the board, its committees and each individual director. The board should disclose how the assessment was carried out and its outcome.

For Large Companies, the board engages independent experts periodically to facilitate objective and candid board evaluations.

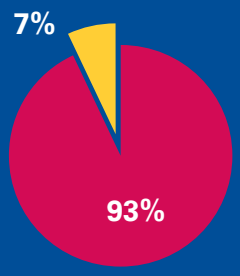
Note: Large Companies are those with market capitalisation of RM 2 billion and above or those on the FTSE Bursa Malaysia 100 index

A total of 581 listed companies with financial year end on or after 31 December 2017 have produced annual reports and corporate governance reports (as at 1 October 2018)

There is a total of **95 Large Companies** and **486 non-Large Companies**

95
Large Companies

486
Non-Large Companies



93% of the companies have applied Practice 5.1 of the MCCG

Parties engaged for external board evaluation

Comparison of external parties engaged by Large Companies versus non-Large Companies.

Frequency of externally facilitated board evaluation

Only Large Companies have disclosed the frequency in conducting externally facilitated board evaluation.

Disclosure of outcome

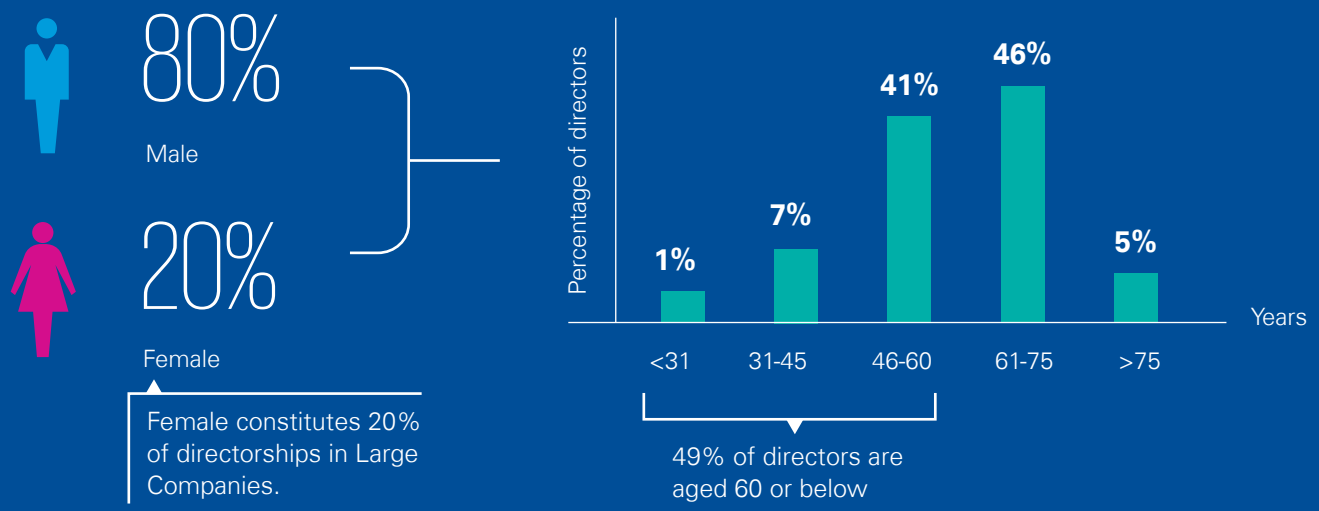
56% of **Large Companies** that have applied Practice 5.1 disclosed the outcome of their board evaluation in their annual reports or corporate governance reports

58% of **non-Large Companies** that have applied Practice 5.1 disclosed the outcome of their board evaluation in their annual reports or corporate governance reports

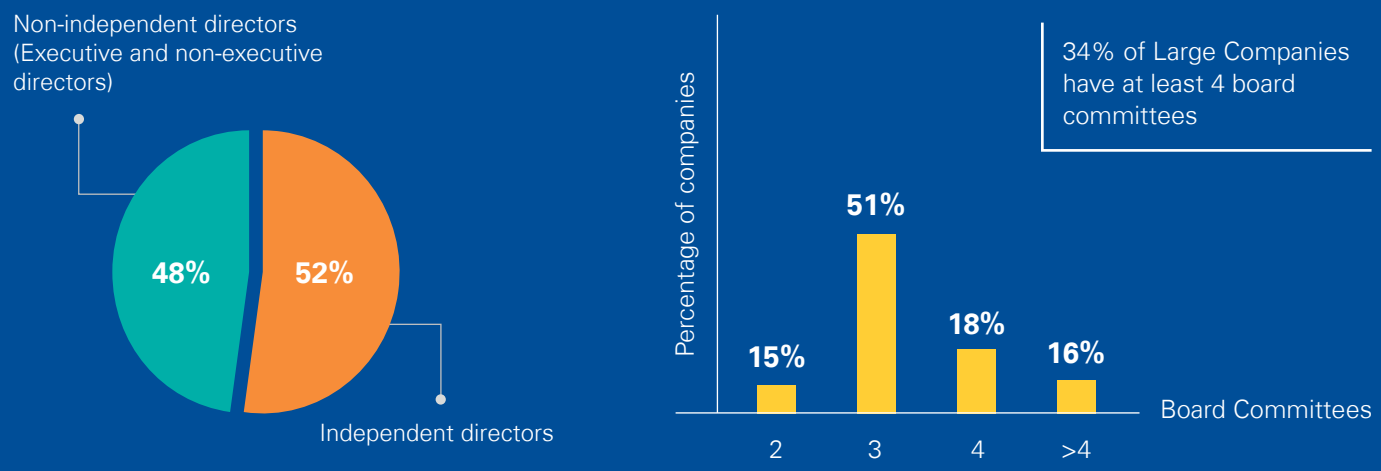
Demographics of boards across Large Companies

There is a total of 819 directors across 95 Large Companies that have produced annual reports as at 1 October 2018 with financial year end on or after 31 December 2017. Key statistical information on board demographics of Large Companies is provided below.

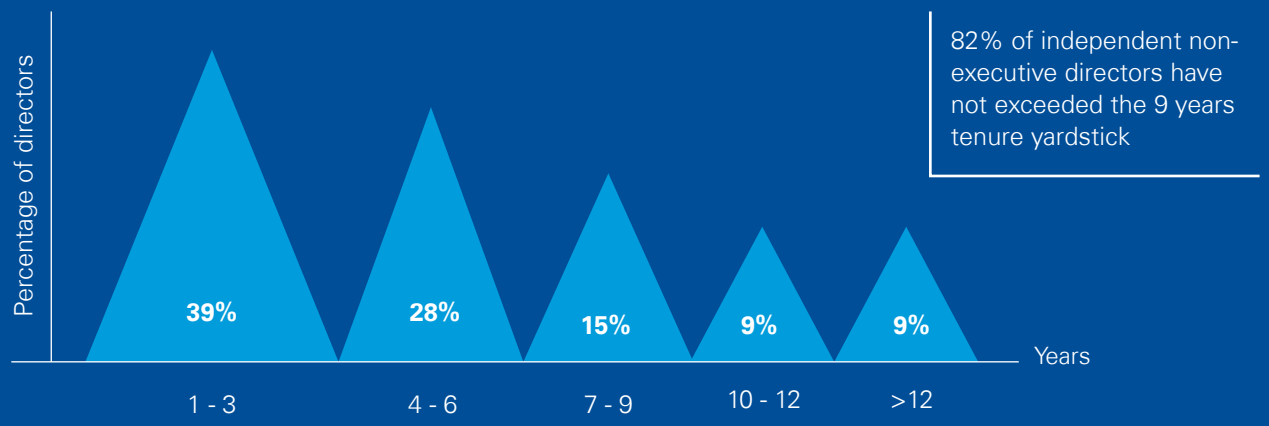
Demographics of directors across gender and age



Composition of independent directors



Tenure of Independent Directors



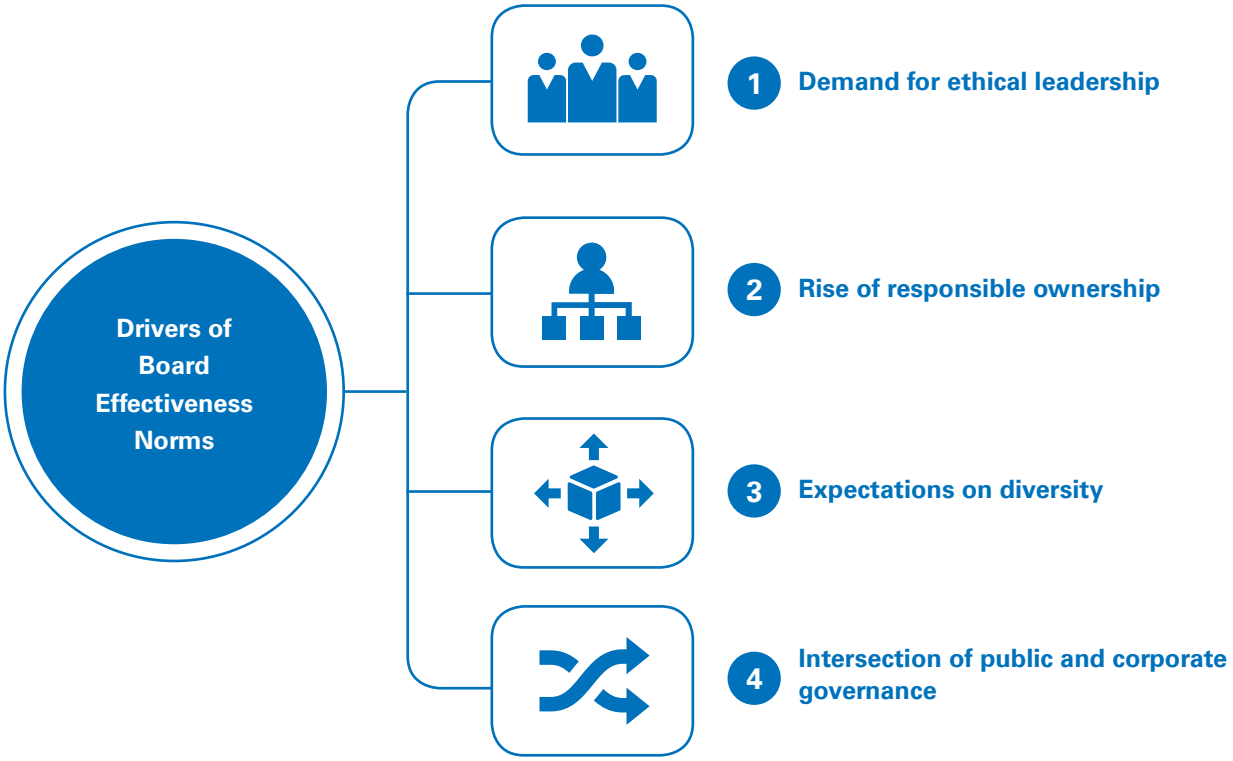
Drivers of board effectiveness

The recent years have been eventful in the space of corporate governance with regulators, shareholders, and the public continuing to ratchet up their focus on this agenda. In order to appreciate this point, we need to look no further than the recent slew of revisions to corporate governance promulgations and the intensified shareholder engagements that are taking place globally. For the record, at least thirty jurisdictions have revamped their codes of corporate governance over the last three years and there are close to one thousand investor campaigns taking place annually with over 60% of them being governance-centric [2].

At the very heart of these reform measures lies a focus on board effectiveness, specifically on the algorithms concerning the composition, structure and function of the board. The posturing of boards as the centre of gravity is premised on the fact that boards not only determine the direction, success or failure of the company, but also influence the society and environment through the actions of the company that they steer.

To this end, the simple act of putting board evaluation on the horizon can create a ripple of change. Individual directors will become more mindful of their performance and consequently, seek to "up their game". Simply put, board evaluations force boards and individual members to take a step back and reflect on the "person in the mirror".

The key drivers that are reshaping the narrative of board effectiveness are as follows.



Source: Board Evaluation: Mutual Admiration or Thoughtful Reflection?, KPMG in Malaysia

2 *The Activist Investing Annual Review 2018*, Activist Insight

1. Demand for ethical leadership

Rules and sanctions clearly have their place, but will not on their own deliver productive behaviour over the long-term, as manifested from the manifold egregious actions over recent years. Fostering a healthy culture is therefore key to both protect and generate value.

Given the importance of culture, board members, in particular, are expected to embody the desired culture and embed it at all levels and in every aspect of the business. In this context, boards are expected to demonstrate ethical leadership and "connect strategy to values", "align values and incentives" as well as "bring those values to life".

The emphasis placed on the leadership team to drive culture and curb nefarious behaviour is perhaps best exemplified by the newly reposed corporate liability provision in Malaysia, effected vide **Malaysian Anti-Corruption (Amendment) Act 2018**. Essentially, under this provision, directors and members of management will be made vicariously liable for corrupt practices of a commercial organisation unless it can be proven that the commercial organisation had put in place adequate preventive procedures. This heightened onus placed on board members and management represents a reversal in the traditional legal maxim of "innocent till proven guilty" to a rebuttable presumption of **"guilty till proven innocent"**.

Malaysian Anti-Corruption Commission (Amendment) Act 2018.

The principal Act (Malaysian Anti-Corruption Commission Act 2009) is amended by inserting amongst others the following provisions:

17A (1) A commercial organization commits an offence if a person associated with the commercial organization corruptly gives, agrees to give, promises or offers to any person any gratification whether for the benefit of that person or another person with intent –

a. To obtain or retain business for the commercial organization; or

b. To obtain or retain an advantage in the conduct of business for the commercial organization

17A (3) Where an offence is committed by a commercial organization, a person –

a. who is its directors, controller, officer of partner; or

b. who is concerned in the management of its affairs,

at the time of the commission of the offence, is deemed to have committed that offence unless that person proves that the offence was committed without his consent or connivance and that he exercised due diligence to prevent the commission of the offence as he ought to have exercised, having regard to the nature of his function in that capacity and to the circumstances

(The following only represents an extract from the source legislation)

Eight is great

The road to perdition of the Wells Fargo Bank began with the "eight is great" mantra of its then Chief Executive Officer, John Stumpf. The mantra was the battle cry for employees to get eight Wells Fargo products into the hands of each customer. This directive proved burdensome for the employees of the Bank as they struggled to meet demanding quotas and satisfy the targets put in place by the leadership team. They began to cut corners and opened deposit accounts and credit cards for Wells Fargo's customers, without their knowledge or permission. The fictitious accounts eventually came to light and a swathe of regulatory actions were subsequently meted out against Wells Fargo.

The damage to Wells Fargo's reputation is staggering and the ability of the bank to recover will depend on a sustained commitment to ethics and integrity. This can only be engendered if board members "walk the talk" and create the right enablers for positive and productive behaviours.

2. Rise of responsible ownership

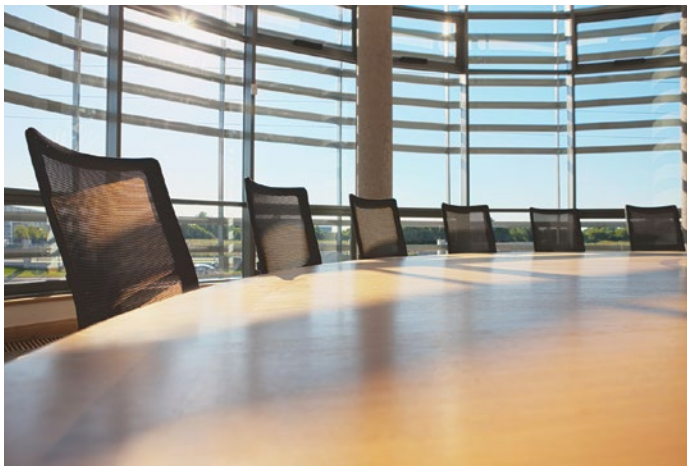
In tandem with the saying, "with great power, comes great responsibility", institutional investors are increasingly reforming their ownership approach against the backdrop of an increase in equity holdings [3]. Given their clout, institutional investors have begun to play a more active role in advocating the long-term interests of investee companies, through board monitoring and shareholder activism. It is becoming increasingly common for institutional investors to demand for meetings with the board members, challenge them on issues of concern and discuss strategies for achieving the companies' goals and objectives. More recently, in Malaysia, we have witnessed a landmark case whereby major institutional investors under the banner of the Institutional Investors Council collectively decided to vote against the resolutions tabled by a company.

As institutional investors continue to spur changes with the message that "poor governance does not pay", it is only natural to expect board members to be more prepared to engage with institutional investors, respond to tough questions and undertake meaningful changes, if necessary.

3. Expectations on diversity

Once the exclusive domain of human rights activists, boardroom diversity has now morphed to be the "order of the day". Rapacious technological advancements, changes in business model, varying consumer demands and emergence of nuanced risks have necessitated for a mix of insights at the boardroom level so as to strengthen deliberations as well as decision making, particularly in the areas of strategy formulation and risk management. The need to have diverse perspectives in the boardroom is perhaps best encapsulated by the saying of a famous management guru and former Chief Executive Officer of General Motors Corporation, Alfred Sloan, who once quipped that "if we are all in agreement on the decision - then I propose we postpone further discussion of this matter until our next meeting to give ourselves time to develop disagreement and perhaps gain some understanding of what the decision is all about".

On the Malaysian front, we have witnessed a greater appreciation for boardroom diversity with policy pronouncements and market led initiatives such as development of directors' registries playing a pivotal role. The fruits of such efforts are evident and the reduced palatability for "all male, pale and stale" boards is a clear case in point. As at early 2018, there are only seven listed issuers amongst the top 100 listed issuers which comprises solely of all male board members [4]. This trajectory is certainly here to stay and companies are increasingly expected to harness the opportunity of refreshing their boards with a view of infusing the element of diversity.



4. Intersection of public and corporate governance

It is undeniable that the global political environment is now more complex and interconnected with the economic environment, thus, resulting in significant fiscal knock-on effects to the general population. Flowing from this, political consciousness is significantly on the rise with an unprecedented clamour for accountability and transparency. This is even more so in countries such as Malaysia where there is a significant proportion of state-owned enterprises or government linked companies that are established to pursue social and national objectives but with a commercial bent.

The heightened scrutiny as a result of the intersection of public and corporate governance have pushed companies, particularly government linked companies to assemble professional boards that can demonstrate accountability to a broad group of stakeholders. Such board members are expected to steer the company against the backdrop of a complex operating and regulatory environment.

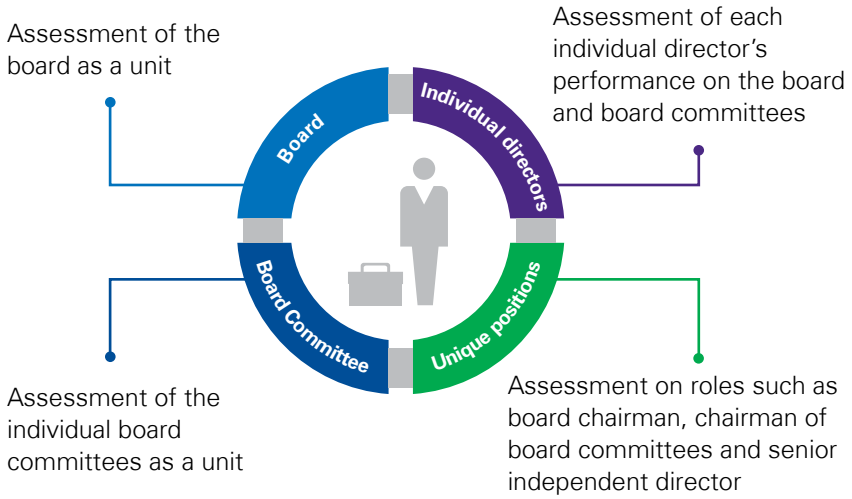
3 Public equity holding by institutional investors is over 80% in Malaysia and 90% in United Kingdom respectively (December 2018).

4 Positive Progress Made on Gender Diversity 2018, Securities Commission Malaysia.

Scope of board evaluation

Whilst the nature and extent of a board evaluation exercise would vary based on the complexity, maturity and nuances of the concerned board, the following considerations can be used as heuristics to determine the coverage of a board evaluation:

Who should be evaluated?



Source: Board Evaluation: Mutual Admiration or Thoughtful Reflection?, KPMG in Malaysia

As enumerated in regulatory promulgations, the subject reviews of a board evaluation exercise should at least include the **board, board committees** and **individual directors** [5].

Given that certain individuals in the boardroom carry added responsibilities based on their unique designations, it is only natural to expect a honed emphasis on these roles, which amongst others include the **chairman of the board, chairmen of the board committees, senior independent director (if any)** and **managing director or chief executive officer**.

In addition, there may be instances in which the board has a specific objective for the evaluation exercise which only involves a particular genus of directors. For example, the board may want to assess the financial literacy of audit committee members or the ability of independent directors to demonstrate independence in "thought and action".

A typical board evaluation exercise would also invariably result in the **company secretary being evaluated** as the board seeks to reflect on how the information architecture and governance counsel support boardroom activities. Whilst this can be done as part of the assessment on the board, there are companies who opt to perform a stand-alone assessment in this regard for an added emphasis.

Bringing shadows into the light

There may be selected cases whereby non-director individuals are in essence calling the shots with regards to governing the affairs of a company as opposed to the named board members (note: such non-director individuals are dubbed as "shadow directors"). For example, an individual under guise of an advisor or member of an advisory committee for the company may wield significant influence and is able to orchestrate proceedings in place of board members.

Recognising the potential for such incidences, the Companies Act 2016 has sought to capture such individuals within the ambit of a "director" if a majority of the board members in the company are acquainted to act in accordance with the person's instructions and directions. Therefore, in identifying the subject reviews of board evaluation exercise, there should be a conscious effort to ascertain whether such "shadow directors" should be part of the consideration. In such a setting, there also needs to be an amplified focus on selected evaluation areas like accountability of the board, transparency, demarcation of responsibilities and objectivity of decision making.

5 Rule/paragraph 15.08A of ACE Market/Main Market Listing Requirements of Bursa Malaysia Securities Berhad and Practice 5.1 of MCCG

In ring-fencing the subject reviews of a board evaluation, the board should be guided by the maxim of "**horses for courses**" instead of the adage, "the more, the merrier". In other words, the board should exercise caution in scoping the subject reviews as the inclusion of too many roles or a highly expanded scope may result in an unwieldy and unproductive exercise.

What should be evaluated?

In determining the criteria for board evaluation, the board may be guided by the overarching themes of "how the board leads", "how the board manages" and "how the board contributes" [6]. Areas that can be considered under the following themes are summarised below:

How the board leads Examine how the directors were chosen, the skills and experience the director brings to bear and the stewardship style.	Example criteria: • Does the board have the right mix of skills and experience to perform its functions with entrepreneurial flair and in a risk-conscious manner? • Is there sufficient diversity on the board? • Does the company's governance structure allow independent directors to perform their roles in a detached manner?
How the board manages Evaluate the manner in which board meetings and boardroom activities are conducted including board dynamics.	Example criteria: • How effective are the key board relationships? • Does the board encourage robust discussion and value the expression of diverse views and pursuit of unpopular stance? • Are conflicts addressed in an appropriate manner?
How the board contributes Review the manner in which board members interact and participate as well as how decisions are made.	Example criteria: • Does the board provide entrepreneurial leadership and counsel to senior management to achieve desirable outcomes? • Is the board constantly alert to opportunities to leverage on the company's capabilities to create value for stakeholders? • Does the board review transactions with vigilance and professional scepticism?

Taking a hard look on the soft aspects

Governance culture is typically driven within the context of the boardroom power structures. Every board has a set of unwritten and tacit norms which shape the process of deliberation and decision making. These norms may not be articulated but they exist nonetheless and are often a function of the character and personal behavioural styles of directors.

Against such a setting whereby cultural context is paramount, the ability of board members to display sound leadership and social aptitude is crucial. These "soft skills" are often the "hardest" to master, thus placing them on the same (if not a higher) pedestal as subject matter knowledge such as finance and business strategy. The ability to encourage diverse views, communicate effectively and make decisions in the face of uncertainty forms the necessary building blocks for excellence in the boardroom.

6 Larcker, D et.al 2017, *How Boards Should Evaluate Their Own Performance*, Harvard Business Review

What gets measured, gets done

Given that executive directors serve as the head of management, it is only reasonable to expect a heightened focus on the evaluation of these group of individuals. All too often, the performance evaluation of executive directors is limited to judgments regarding a company's financial achievements or disappointments of the previous year. Whilst this is important, it is only part of the story. Such a limited view tends to dwell too much on the past, where little can be done to change the status quo. Moving to a balanced scorecard approach will certainly represent a positive step to surface a more holistic and forward-looking picture.

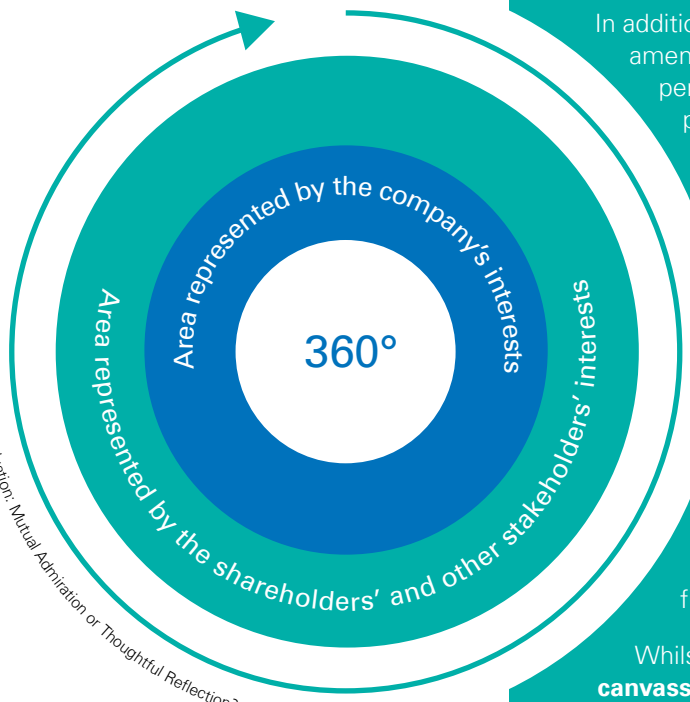
A balanced scorecard approach would certainly allow the board to establish expectations and assess performance based on a wide range of metrics, anchored on the focus areas of performance, customer management, operational management and human resource development.

A balance of metrics which are result-based and behaviour-focused should be considered in the assessment of directors based on measurement of key performance indicators.

How should boards be evaluated?

Boards are commonly evaluated through the deployment of **self-review** (i.e. rating by the individual board member), **peer review** (i.e. rating by fellow board members) or a rating mechanism that involves a combination of the both. A peer review allows findings to be correlated with the whole-of-board outcomes and the appropriateness of any recommendations can thus be corroborated.

In addition to a self and peer review, many boards are now amenable to gather feedback from senior management personnel who regularly interface with the board – a practice that goes by the moniker of **"360 degrees evaluation"**. Such senior management personnel would typically but not exhaustively include the chief executive officer, chief financial officer, chief operating officer and governance officers such as company secretary and chief compliance officer. Whilst this practice may seem counterintuitive as directors, in particular executive ones, are accustomed to evaluating their employees, suppliers and the like, the value of such an exercise cannot be dismantled. In many instances, views surfaced by management have served to provide valuable improvement opportunities such as identification of skill gaps in the board and overlaps in the functionalities of the board and management.



Source: Board Evaluation: Mutual Admiration or Thoughtful Reflection?, KPMG in Malaysia

Whilst not prevalent, it is also not unusual for boards to **canvass the views of those outside the circumference of the company** so as to gather alternative perspectives. For example, a renowned company in the region is known to conduct investors interviews (without the presence of management) to assess the impact of the board's actions to shareholders.

It is evident that involving non-board constituents in the board evaluation process would result in a well-rounded view of the board. However, caution should be exercised as including those that do not or only have tangential involvement with the board could inevitably cloud the findings of the board evaluation exercise.

Modalities of board evaluation

Whilst there is no "silver bullet" for conducting a board evaluation and techniques need to be adapted to the evaluation objective and board context, the following are examples of modalities that can be deployed including through the use of Board Evaluation Software technology. These modalities are commonly used in combination of one and another, as explained below.

Questionnaire

Questionnaires are the most common method of **unearthing responses from directors across a wide range of areas** including board composition, quality of information support and the decision making process. Questionnaires often comprise a mixture of open-ended and close-ended questions with the rating mechanism customarily being a dichotomous scale ("yes" or "no" responses) or a Likert scale (e.g. a rating spectrum of "1" to "4"). A window of a few weeks is usually provided to allow for thoughtful completion of questionnaires by board members.

Recognising that questionnaires may potentially be reduced to a "box-ticking" exercise, many companies are seeking to enrich this process by incorporating **"what-if" or "scenario-based" questions** to explore the board's response to specific challenges. For example, a question posited in the board evaluation questionnaire of a large domestic company read, "if there is a somewhat bona fide appearing whistleblower's report of serious corruption concerning the chairman of board and chairmen of board committees, how would the board react? Would the chairman of board and chairmen of board committees be asked to take an interim leave of absence whilst investigation is ongoing? ".

Document analysis

Review of documents such as meeting minutes, board papers and governance policies can be a powerful source of information to identify improvement opportunities. Review of documents is also a useful means of minimising self-rater bias and corroborating information- as the saying goes, **"if it is not documented, it is not done"**. For example, a director may view himself or herself in an overly positively light and claim that he or she always asks probing questions and following up on all matters which requires further attention but a review of meeting minutes may reveal otherwise.

A document analysis is typically augmented with a diagnostic review in which the facilitator benchmarks the practices of the company against regulatory promulgations and best practices, having taken into account the observations gathered from the review of documents.

Interview

Interview (either face-to-face or electronic conferencing) provides a unique opportunity to collect rich information such as **directors' perceptions and areas of ambiguity** by asking questions in a way that allows directors to express themselves. Simply put, oral discussions may allow directors a greater opportunity to express concerns and raise issues in a thoughtful and complete manner.

Interviews can fall along a continuum between being structured (where directors are asked a series of pre-set questions) and unstructured (where there is no pre-set questions and the aim is to surface preliminary issues for further investigation). Generally, more specific topics of interest benefit from a structured interview, whilst more general questions benefit from a less structured approach.

Board meeting observation

Board meeting observation, or more fashionably known as **"mystery shopping"** is a technique used by the facilitator to **observe the boardroom proceedings in a real-time setting**. Whilst there is a risk that directors' behaviour may be scripted when they are being observed, a first-hand view of the board dynamics and exchanges between directors during live meetings can serve as a useful input when providing advice and recommendations on boardroom dynamics.

Internally facilitated vs externally facilitated evaluation

Regulatory reforms in recent years have created a drive for externally facilitated evaluation on the premise that it can add value by introducing a fresh perspective and new modes of thinking. Externally facilitated evaluation may also be useful in certain circumstances, such as when there is a new director or if there is a known problem on the board, requiring tactful handling.

In certain companies, the third-party approach to board evaluation has been met with resistance. In some instances, the chairman considers evaluation as part of his or her personal remit as the board's leader, and, in many other cases, boards are wary of exposing their internal culture and decision making to outsiders.

The perceived advantages and disadvantages of an internally and externally facilitated evaluation can be captured by the following quotes as gathered from interactions with company secretaries and directors of listed issuers in Malaysia.

> Unlike an internally facilitated evaluation which generates endorphins and makes the results fine, an externally facilitated evaluation may surface issues which might be swept under the carpet under an in house process
>
> - Director of a large property company

> External facilitators typically sugarcoat findings and conceal the hard truths for the fear of losing future business opportunities with the company
>
> - Director of a KLCI constituent company

> Directors tend to be more open towards a bipartisan body as an external facilitator depersonalises the process
>
> - Company Secretary of a large plantation company

> Externally facilitated evaluations may involve an element of self-review, especially if the facilitator recommended the sourcing of the concerned directors who are subject reviews of the evaluation. It is akin to "liking your own Instagram photo"
>
> - Company Secretary of a large property development company

Rigour to savour

In its recently released Corporate Governance Report, a Kuala Lumpur Composite Index ("KLCI") constituent company had narrated how a rigorous externally facilitated evaluation had helped it to enhance its board effectiveness. The external facilitator was a professional service entity with **no commercial relationship with the company**.

The evaluation was conducted through questionnaires (self and peer review mechanism) and follow-up interviews with each of the directors. The process covered a variety of areas including board composition, the content and administration of meetings and corporate governance. **Comparative analysis** was conducted where the same questions were asked of board members to identify trends. Summary reports were drawn up on the performance of the board, board committees and chairman.

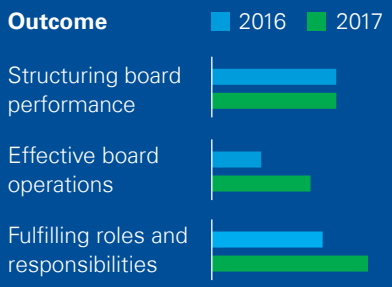
All in all, evaluation provided the directors with the opportunity to consider how boardroom activities and governance policies influence performance. A number of actionable next steps were also agreed as a result of the board evaluation outcome, with particular reference to succession planning, strategic management and board meeting format. In addition to helping identify **areas for potential adjustment**, the evaluation provided an opportunity to remind directors of the importance of group dynamics and effective processes in fulfilling board and board committee responsibilities.

Look back, avoid setback

In the case of mid-capitalised company in the industrial products sector, the company conducted an internally facilitated evaluation but sought the help of an external party to enhance the questionnaires on its behalf. The assessment questions were modelled based on relevant regulatory promulgations, guidelines and best practices including the "Green Book – Enhancing Board Effectiveness" issued by Putrajaya Committee on Government Link Companies (GLCs) High Performance.

Interestingly, in a somewhat unconventional disclosure made vide its Corporate Governance Report, the company disclosed the actual scores of the respective assessment sections with the previous year benchmark recorded for comparison. The year-on-year comparison allows the company to monitor progress and assess if actionable steps undertaken have yielded the intended outcome.

Sample outcome disclosure



Source: Adapted from an annual report of a listed issuer

"An external facilitator brings a fresh look through a new pair of lens

- Director of a large oil and gas company

An externally facilitated evaluation is a mere "icing on the cake" as it is theoretical and process driven

- Director of a FTSE 100 company"

"External facilitators deliver expertise gathered from their vast repository. They help to draw benchmarks from other companies, identify trends and recommend areas for examination

- Director of a large financial institution

Who watches the "watchers"? External facilitators are unregulated

- Director of a mid-capitalised pharmaceutical company"

"Directors accord greater attention and thought for an externally facilitated evaluation due to the rigour that entails

- Director of a large services-based company

An overly dogmatic approach in the methodology and reporting approach of an externally facilitated evaluation may result in a frosty relationship between directors

- Director of a large energy-based company"

"An externally facilitated evaluation provides a better basis for investor confidence

- Director of a large property development company

Source: KPMG's intelligence and internal repository based on past interviews with directors and company secretaries

Common discoveries from board evaluation

Strengths

Demarcation of responsibilities between board and management

- Findings from board evaluations exercises indicate that boards are increasingly focused on clearly **defining lines and boundaries with management**.
- Boards are typically guided with notions such as **"delegate" and "supplement"** to facilitate communication between themselves and management.

Board skill sets

- Many companies have **established a board skill matrix** with a view of getting directors with the right "fit".
- Meritocracy has paved the way for boards to be diverse.
- In enlisting directors of the right skillsets, the **utilisation of search firms and registries** has been prevalent.

(Refer to Figure 1 in Appendices)

Board commitment

- To quote a director of FTSE 100 company in Malaysia, "some **individuals regard a board position as a passion** rather than a vocation"
- Many directors are now prepared and engaged with the affairs of the company.

(Refer to Figure 2 in Appendices)

Boardroom dynamics

- In a setting characterised by **collegiality, candour and professionalism**, board members are able to ask uncomfortable questions.
- Companies have come to realise that preserving the cohesiveness of the board hinges on the functionality of the board chairman.

Improvement Considerations

Strategy

- Assessment results commonly indicate that boards should **devote more focus on their value creation role, particularly on strategy**.
- The balance of boardroom agenda which is heavily tilted towards compliance and related matters **further compounds the lack of attention** on strategic matters by boards.

Remuneration

- Remuneration packages **should take into account the complexity of the business** and the individual's responsibilities and long-term objectives of the company.
- In the **case of executive directors**, this would include taking into consideration the performance of the company.

(Refer to Figure 3 in Appendices)

Information flow

- In relation to board papers and accompanying materials, there are concerns that **such materials lead to a sensory overload**.
- It should be noted that presentation of materials in an **overly voluminous manner pose a risk** with respect to directors being unable or unlikely to decipher and review them in detail.
- Such an information architecture is often described as "**information rich but insights poor**".

(Refer to Figure 4 in Appendices)

Meeting administration

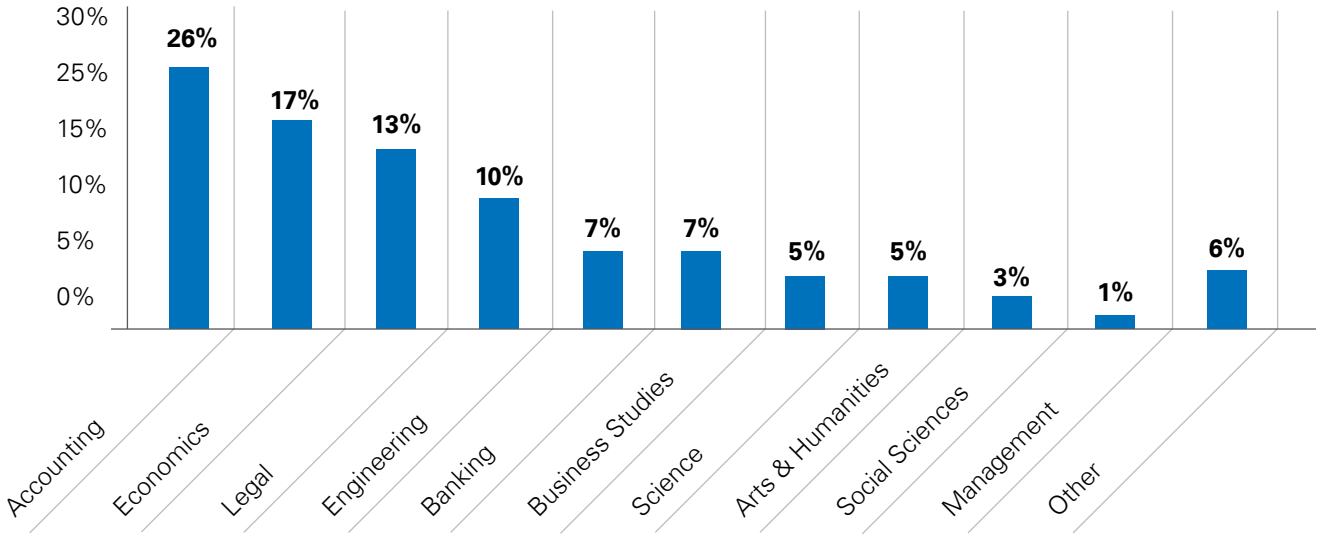
- It is not a rarity to witness immediate successive board and board committee meetings being **held to accommodate the logistical preference** of selected directors.
- For example, one company went as far as having a meeting marathon of **15 hours on a single day.**

Succession planning

- There exists a **lack of concerted focus** to formulate a cogent plan for **the orderly succession for appointments to the board and senior management**.
- It can result in **hasty promotion** of individuals who may be **unsuitable or unprepared** for the position.

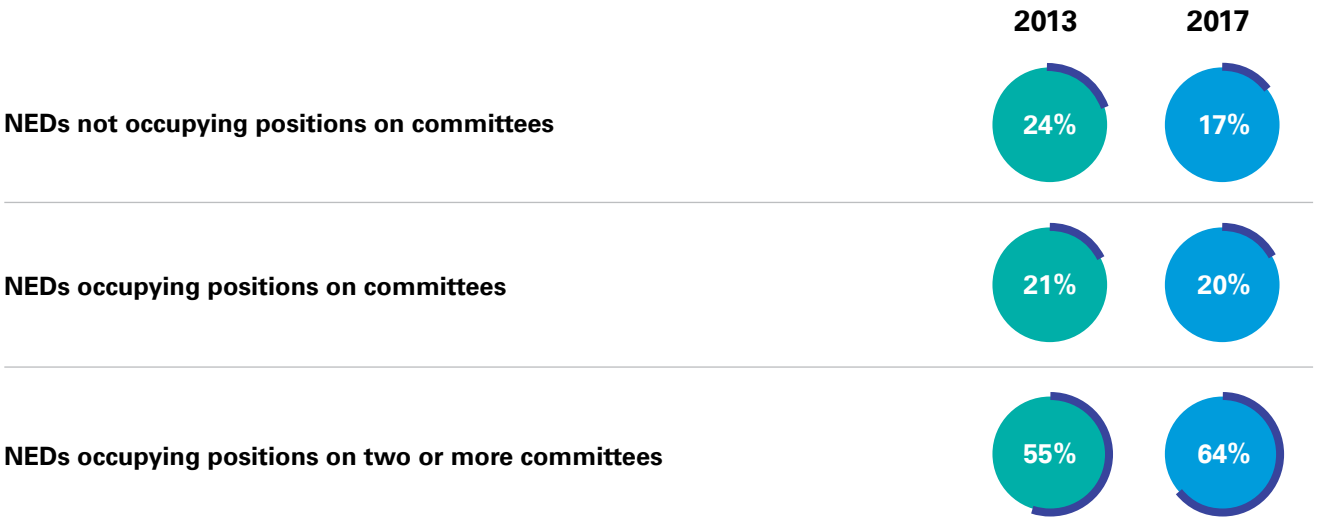
Appendices

Skill set of non-executive directors ("NEDs")



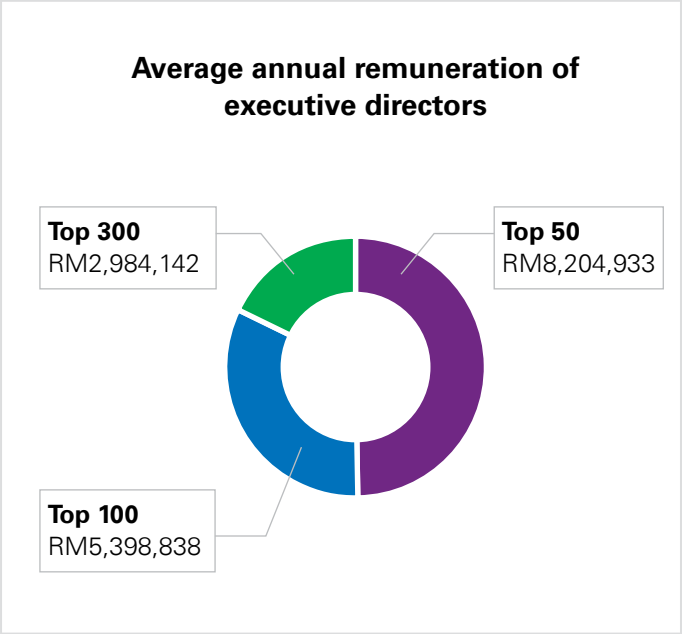
Source: KPMG's intelligence on the skill set profile of NEDs based on the top 300 listed issuers by market capitalisation (derived from annual reports as at 31 July 2017)

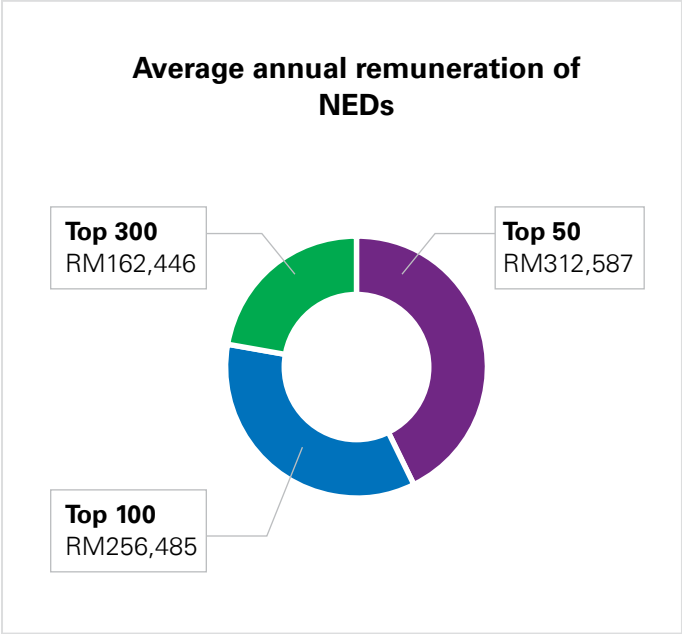
Figure 1: Refer to Strengths: Board skill sets



Source: KPMG's intelligence on board committee occupancy by NEDs based on the top 300 listed issuers by market capitalisation (derived from annual reports as at 31 July 2017)

Figure 2: Refer to Strengths: Board commitment

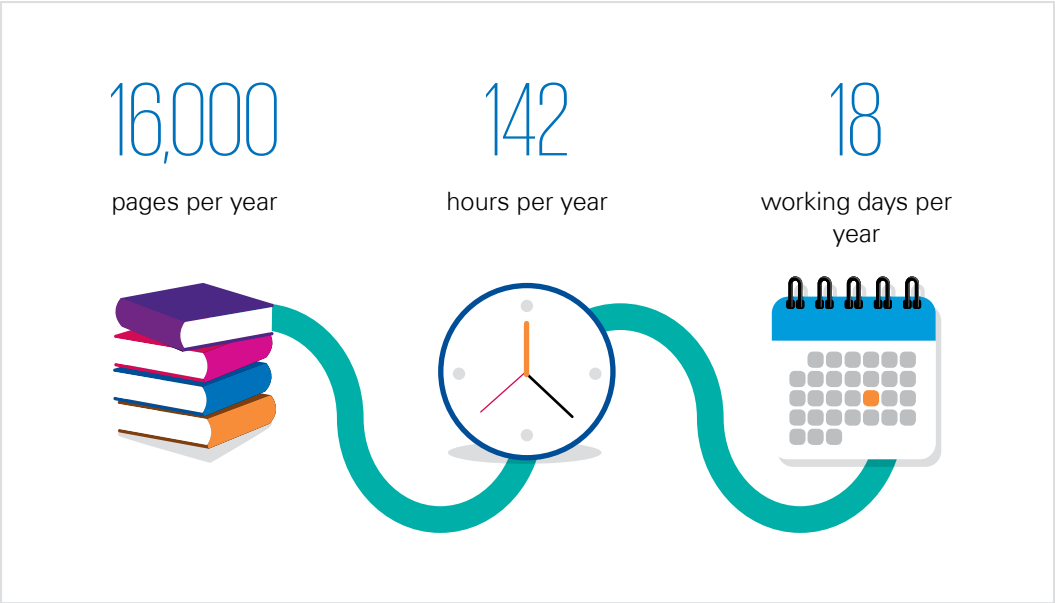




Source: KPMG intelligence on directors' remuneration based on the top 300 listed issuers by market capitalisation (derived from annual reports as at 31 July 2017)

Note: Average shareholding held by an independent director stands at 0.2% of the company's total share capital

Figure 3: Refer to Improvement Considerations: Remuneration



Source: Board Evaluation: Mutual Admiration or Thoughtful Reflection?, KPMG in Malaysia

Figure 4: Refer to Improvement Considerations: Information flow

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