



BOARDWORKS

International

Chief Executive Performance Management

In most organisations the chief executive is the sole point of leverage a governing body has over organisational achievement. A board's ability to communicate its expectations to its chief executive and to monitor how effectively these are achieved is, therefore, critical to a board's effectiveness. In our experience, very few boards fulfil this aspect of their role as well as they (and their chief executives) would wish. Common shortcomings include the following.

- Expectations are not clearly expressed or regularly updated to reflect changing circumstances. Consequently, chief executives orient their performance to expectations that were relevant at the time of their appointment but may no longer match what is required to be successful in the position.
- In part, this may be due to reliance on the job description as the sole explicit statement of expectations. A traditional job or position description is an inadequate basis for effective performance management. It not only becomes quickly out of date but also tends to be somewhat prescriptive in format. This has implications for the board's ability to hold the chief executive accountable.
- If annual performance objectives are set at all, these are usually described in terms of activities rather than outcomes. Performance can only, therefore, be assessed in terms of the degree of 'busy-ness' (and/or effort) rather than the level of achievement.
- When objectives are remuneration-linked, chief executive behaviour is often distorted (e.g. by rewarding short-term thinking and the manipulation of 'the numbers'). It is not uncommon for chief executives to experience feelings of being manipulated or coerced and, particularly, of being punished (e.g. when anticipated rewards are withheld) by their board. Too often, particularly in the commercial sector, a chief executive's performance 'evaluation' is principally about the amount of the 'bonus' or 'at risk' portion of the chief executive's remuneration to the exclusion of a more direct discussion about how well the chief executive role is being performed.
- The types of matters that typically raise a board's concern about their chief executive's performance (often relating to the chief executive's behaviour) are seldom made clear to the chief executive or specified in a manner that is capable of fair assessment.
- The responsibility for the performance management of the chief executive is delegated (or abrogated) to the chairman. The chairman's job is to manage the board not the chief executive. The specification of a one-on-one relationship encourages the

sense that there is a superior/subordinate relationship that is inappropriate. Because the chairman tends to work more closely with the chief executive than other board members s/he is less likely to feel that a structured, systematic process is needed and will find it relatively difficult to be the most objective assessor. Leaving chief executive performance management to the chairman also concentrates too much power in one person and means that board members' individual assumptions about what is expected of their chief executive are seldom tested.

- Monitoring tends to be episodic and 'hit and miss' rather than focused and systematic.
- Performance feedback is infrequent and often confined to what has gone wrong. Chief executives are often confronted with unpleasant surprises having had no previous hint of board concern with their performance.
- Chief executive 'performance review' is often in response to a crisis rather than as a proactive, scheduled process. One of the consequences of this is that it is perceived by the chief executive to be punitive rather than constructive and helpful.
- Assessment of the chief executive's performance is often based on unrealistic or unfair criteria. For example, many chief executives experience a process that judges them on what they are like as a person rather than what they have achieved in the role.
- The board does not commit the time and attention the process deserves which also sends negative signals to the chief executive. At worst, chief executives work in a vacuum.
- The performance management process is something that is 'done to' the chief executive rather than part of an ongoing 'coaching' type of relationship that is part of a partnership *with* the chief executive.

For these and other reasons it is not uncommon that the chief executive performance management process is, at best, ineffective and, at worst, demotivating and a cause of disharmony and ineffective teamwork between board and chief executive. Many chief executives complain the process is ad hoc and unfair, even unethical. It is something to be avoided by both parties rather than positively anticipated and constructively applied. Not uncommonly, boards muddle through and create an undesirable situation that damages the relationship with the chief executive and the potential for better processes to be developed in future.

A recommended approach

The board should be explicit in the philosophical stance it wishes to underpin its approach to the chief executive performance management process. We suggest the following principles as a starting point for the board's consideration. Any given board may well choose to either add to this list or set some principles to one side.

- The Board has a vested interest in the Chief Executive being successful. The performance management process should be directed towards that goal.
- The Board must do its own job first, setting the policy and delegations framework from

which the chief executive's performance criteria would be derived. For example, clarifying:

- Corporate philosophy and values;
 - Fundamental organisational purpose;
 - Outcomes/results (i.e. 'ends') to be achieved (both short-term and long-term) and immediate priorities;
 - Chief Executive authorities/delegations; and
 - Expectations about the respective contributions of Board and Chief Executive to particular matters.
- Until such time as the Board has agreed its expectations of the Chief Executive, and can speak with 'one voice', there is effectively no instruction to the Chief Executive.
 - To ensure that the performance management process has a forward looking, developmental orientation, and is not about reward and punishment, it should be separated from decisions about remuneration.¹
 - The Board has a responsibility as a 'good employer' to ensure that it applies principles of fairness and natural justice and that its approach is ethical.
 - Reciprocity – the Board should treat the Chief Executive the way its own members would wish to be treated if they were in the role - with honesty and openness.
 - The primary focus of the evaluation process should be on the extent to which the board's expectations of the Chief Executive's role are fulfilled, not on the person in the role. For example, if, in the first instance, a chief executive who has *acknowledged* shortcomings in some areas employs others to ensure those parts of his/her responsibilities are performed well, they should not be any less well thought of as a consequence.
 - There should be clarity about what the Board intends to do as an outcome of the process.
 - Praise due, and constructive criticism, should be given in a timely manner (and not stored up to be communicated – if at all – in an end-of-year review).
 - No one director (and particularly not the chairman) should have sole or even primary responsibility for the chief executive performance management process. To do so gives too much power to one individual and puts the board/chief executive relationship at risk for a number of reasons (see common shortcomings on pages 1 and 2).
 - While a sub-group of the Board is best suited to the direct management of the process, all board members should have the chance to participate in the implementation of the chief executive performance management process. The Chief Executive works for the board as a whole. The Board as a whole is accountable for

his/her performance.

Based on these principles we generally recommend the following process be adopted:

1) Assign responsibility.

Establish a standing committee of the board (the Chief Executive Employment Committee) that has the responsibility on behalf of the board to see that there is an effective and positive employment relationship between the board and chief executive and to lead the process steps set out below. In many organisations this is called the 'remuneration' committee but its responsibility is both more important and far broader ranging. That is not to say there should not also be a remuneration committee which addresses both senior executive and (if relevant) board remuneration. Because chief executive performance management and chief executive remuneration should be thought of as separate matters, there is a benefit in having these two aspects of board consideration dealt with by separate committees. The Chief Executive Employment Committee takes the lead in the following process steps but has the responsibility of ensuring other board members are consulted and engaged in the dialogue at appropriate stages so that the whole board is ultimately accountable for the quality of the employment relationship. Other committees may also be involved in parts of the process.

2) Review the 'Recruitment Specification'.

A traditional 'job description' has limited utility in effective chief executive performance management. Its principal application is at the time of recruitment. It is a signal to the incoming chief executive about the dimensions of the position. It assists in assessing the 'job size' and, thus, in establishing the starting remuneration. Either explicitly or implicitly (more usually the latter) it indicates the types of challenges that must be met by the incumbent. Because it is applied principally in the recruitment phase and seldom thereafter, it quickly becomes out of date in most organisations. Consequently, what the job description says or implies about the position can diverge quite rapidly from the actual nature of the chief executive role and the demands placed on the person who performs it.

An inability to identify and acknowledge this progressive divergence is a significant explanation why some boards become progressively dissatisfied with their chief executives' performance. Some chief executives adapt very successfully to changing demands on them and their organisations. There is no logical reason, however, why a chief executive appointed on the basis of a strong match between their capabilities and the demands of the job should continue to succeed when those demands change to any significant extent. Chief executives, therefore, are now being urged to consider the role, not in terms of an open-ended assignment, but, rather, in terms of a project with a definite start and finish. So long as there is a close correlation between what the organisation needs and what the chief executive can contribute, there is no reason why the 'project' should not continue. The suggestion is, therefore, that both board and chief executive should develop an explicit understanding at the time of recruitment, that the job to be done will, eventually, come to a natural end. When that time comes (perhaps sooner rather than later) the chief executive should be looking for a new 'project' and the board should be looking for a new chief executive. There is, however, neither personal fault nor failure. This is quite different from the circumstances in which many board/chief

executive relationships are terminated.

For this reason the Chief Executive's Employment Committee should regularly review and revise a document which is more appropriately termed 'a chief executive recruitment specification'. This should be the first stage in each new chief executive performance management cycle (i.e. annually). The establishment and maintenance of such a document ensures that the board is always thinking about the demands on the chief executive *position* and the type of skill set that is needed to succeed in the role. Furthermore, it can do so without any particular need to refer to the employment relationship with its current chief executive.

Separating the revision of a chief executive recruitment specification from a consideration of performance planning and evaluation specifically relating to the incumbent ensures that the board (or the Chief Executive Employment Committee on its behalf), is always operating from a solid and dispassionate foundation. Before it proceeds to any subsequent stage it gains a clear focus on what is (or should be) demanded from the chief executive role, and an updated understanding of the capabilities most likely to be needed by the person who is charged with fulfilling those expectations. The thinking that flows from this annual review of the recruitment specification can then inform the committee's performance management-related dialogue with the incumbent chief executive.

3) Set expectations - performance planning.

a) Timing – In the first instance this stage in the process should occur annually before the commencement of the new performance review period. This usually means before the start of a new financial year. Expectations should also be reviewed at various points during the year to ensure these continue to be relevant.

b) Performance specification – key requirements in respect to the 'performance plan'

- i) For the sake of consistency and internal alignment between various planning statements, expectations about the chief executive's performance in the forthcoming year should be drawn, as far as possible, from existing statements of organisation purpose, and the key strategic outcomes the organisation must achieve². In some types of organisation other accountability documents like a statement of corporate intent may also be relevant.
- ii) This list of performance expectations should be kept short, simple and unambiguous. These should be outcome, not activity based – focusing on the results to be achieved not the work to be done.
- iii) It should leave no doubt about the major priorities on which the board wants the chief executive to concentrate his or her *personal* attention. Such expectations should be realistic and achievable but require the chief executive to achieve a degree of performance 'stretch'.
- iv) This performance plan should be developed in conjunction with the chief executive and reflect a shared sense of the main challenges facing the organisation, the board and the chief executive personally. Such challenges

should be documented to use as a reference point in monitoring and reviewing performance later. As part of this process the committee should also invite the chief executive to outline the support s/he needs from the board in order to be able to meet its performance expectations and to be successful in the role. The committee should also indicate what the board needs in terms of support from the chief executive. This part of the performance planning process is particularly important because it is where the board/chief executive partnership often falls down.

- v) To avoid the temptation to engage with the chief executive on *how* desired results should be achieved, and to increase the chief executive's commitment to the implementation of the performance plan, the committee should invite the chief executive to formulate the performance measures or indicators. The chief executive is asked, in effect, to think through how s/he will 'prove' to the committee that the board's expectations have been achieved. The dialogue between the committee and the chief executive about his/her proposed performance indicators helps to ensure that the basic performance expectations are clear and that the indicators proposed will be accepted by the committee as useful and valid.
- vi) One final element, if it has not been included in any of the previous steps, is agreement between the committee and the chief executive about initiatives that will be undertaken to enhance the chief executive's performance in the role including steps needed to address previously identified performance issues where these exist.

c) Review and reconfirm delegations. The chief executive is responsible for achieving the desired results within a framework of delegated authority that defines the boundaries within which s/he is expected to exercise his/her own judgment without further reference to the board. Just where the boundaries are drawn around this 'chief executive activity space' must explicitly reflect organisational values and the board's appetite for risk. For many organisations there will also be relevant statutory, regulatory or contractual restraints that should be acknowledged. The authority delegated by the board to the chief executive should be reviewed and confirmed as an essential part of the performance management process (note, however, that because of the 'risk' focus this aspect of chief executive performance management may be undertaken in the first instance by a board committee that has responsibility for the oversight of risk). To ensure that the boundaries of the chief executive's freedom are clear and to achieve an optimal balance between board control and chief executive empowerment we recommend that these delegations be expressed in the form of proscriptive 'limitation' policies. Depending on a particular board's assessment of chief executive performance risk, such limitations are most likely to be specified in relation to matters such as:

- i) Communication and support to the board
- ii) Financial planning
- iii) Financial condition

- iv) Treatment of staff
- v) Treatment of customers/clients/stakeholders, etc
- vi) Protection of assets
- vii) Public affairs.

4) Performance monitoring and feedback.

Monitoring the chief executive's effectiveness should be thought of, and explicitly acknowledged, as a continuous process. Every board meeting, and every interaction with a board member outside the board meeting context, is the catalyst for some form of evaluation even though this may go no further than the unconscious minds of individual board members. Each board meeting, therefore, is an opportunity to be more transparent. It is a chance for the chief executive to report to the board about progress and for the board to let the chief executive know how things are going from its perspective.

If this type of feedback does not occur, the chief executive is deprived of the motivation that comes from acknowledgement of what is going well and the opportunity to become more effective if something is not as it should be.

There is considerable value in more explicit, more formal, reviews of chief executive performance at various points during the year. Greater formality in the process ensures there is a specific focus and that the chief executive is assessed only against performance criteria that have been previously agreed within the board and between the board and the chief executive. The approach that we have found works best is to conduct "semi-formal" reviews every four months. This is frequent enough to allow a new course to be set if the board's expectations change or if the chief executive's performance is considered unsatisfactory. The end-of-year performance appraisal, the only attempt at performance feedback in many organisations, should be thought of primarily as an opportunity to formally overview and "wrap up" the performance picture for the year as a whole.

The starting point for each of these semi-formal reviews should be a written self-assessment prepared by the chief executive in respect of the board's expectations as documented in the performance plan. When the end of the year assessment is carried out there is also value in the board seeking evaluation information from a wider range of sources (e.g. staff and stakeholders). Information sought from these sources should be confined to applicable performance criteria.

These semi-formal reviews and the end of year appraisal should be based on a thorough dialogue between the committee and the chief executive. Both parties should reflect on how the year's performance has gone and be open about what succeeded and what might have been done better. The scope and conclusions of the reviews should be reported back to the full board and be well documented so that there is a clear record, progressively built up, of the individual's effectiveness in the role of chief executive.

- 1 Designing a chief executive performance management system to produce a direct remuneration outcome not only ignores the conceptual flaws in 'performance pay' (including perverse incentives) and the complexity of chief executive motivation, but oversimplifies the matters that should influence a change in remuneration. Performance of the individual in the job is only one among many factors that should influence a board's remuneration decision (other matters include, for example: the desirability of maintaining parity with market movements; the risk of losing the chief executive's services to another higher paying organisation; changes in scope and demands of the chief executive position; the ability of the individual in the role to make a greater contribution because of increasing experience in the position; the performance of the entity itself and its ability to pay; the implications for changes in internal relativities (e.g. between the chief executive and his/her direct reports) and the 'flow-on' implications for the motivation and remuneration expectations of other employees when the chief executive is rewarded – often in a very public way - but other staff who have contributed to the result are not).
- 2 These are likely to be drawn from the Strategic Plan or its equivalent.