



## BOARDWORKS *International*

### **Managing Your Greatest Asset (and Your Biggest Risk)**

Does your board know for certain that your chief executive is doing a good job? Does your chief executive have a clear sense of the board's expectations; does he or she work in a vacuum? Is he or she satisfied with the quality (and quantity) of performance feedback from the board? These are vital questions that boards must be able to answer with confidence.

In recent issues of *Good Governance* we have explored a number of issues to do with *recruitment* of the right chief executive. Selecting the chief executive is perhaps the most important decision a board gets to make. It is often accompanied by a tangible sense of relief around the board table, particularly if there has been some concern about the organisation's performance. Regardless of organisational circumstances most boards are willing to stand back and give their new chief executive room to make his or her mark on the organisation.

Care must be taken, however, that these thoughts do not lull the board into an unspoken sense that its work is done – that it can now sit back. In this article, the first of three on this topic, we explore why a board needs to be proactive in that part of its job that involves managing the performance of the chief executive. We also outline some of the basic concepts and considerations in chief executive performance management.

We distinguish between the board managing the chief executive and its management of the chief executive's *performance*. The distinction is an important one. The board is not another level of management sitting above the chief executive. In any case it is often the situation that a board does not have the knowledge or experience to directly oversee how the chief executive does the job. Every board, regardless of its own competencies, does, however, need to ensure that its chief executive meets the board's performance expectations.

#### **Barriers to the adoption of a systematic chief executive performance management process**

To begin with we look at why effective management of the chief executive's performance is so important. No matter how well the board has chosen its chief executive many things can impact on that person's ability to get the job done. The job itself, and the expectations that accompany it, can change markedly in a short space of time. Nor can a chief executive work for long in a vacuum – he or she needs to know how the board, collectively, views their performance.

Few boards would consider it wise to simply leave the chief executive to his or her own devices. For a variety of reasons, however, that is more or less what happens in those organisations that lack an objective, systematic and *effective* approach to chief executive performance management. Even some that have nominally committed to a proactive approach find it difficult to put their good intentions into practice.

There are a number of reasons why boards tend not to be as good as they need to be at the management of their chief executive's performance. Some of these reasons relate to the board itself, others to the chief executive.

The board, for example:

### **1. does not see the need for an explicit process**

In many organisations there is no formal process in place to articulate explicit performance expectations against which to subsequently review the chief executive's performance. Board members in those organisations commonly express such views as:

- The chief executive knows what we expect of him and how we think he is doing already – we don't need to spell it out.
- What's the point - she knows what the organisation has to achieve better than we do.
- The organisation is doing well, why bother? (if it ain't broke why fix it?)

Most chief executives welcome and need timely and objective performance feedback. If there is a problem a chief executive is as entitled as any other employee to have this pointed out in a constructive way and to be given an opportunity, within a reasonable time frame, to lift their performance. This cannot occur if there is no starting point - a formal statement agreed of desired performance outcomes.

### **2. has not completed vital aspects of its own work**

A board cannot abrogate its own ultimate stewardship role. Regardless of the qualities of the chief executive the board can never delegate its ultimate responsibility to determine corporate purpose, direction and priorities or to decide the context within which risks facing the organisation should be managed. If it has not fulfilled those twin aspects of its responsibility it forces the chief executive to work in a sort of 'expectations vacuum'. It has provided no framework from which performance expectations can be derived. The board cannot ethically judge the performance of the chief executive until it has done – or at least begun – these aspects of its own job.

### **3. contains too much wishful thinking**

The board has a natural desire for the chief executive to do well. The board wants (and needs) the chief executive to succeed. There is quite some reluctance, therefore, to acknowledge any evidence to the contrary. Optimism and wishful thinking about the chief executive often hold a board back from taking timely action until the evidence that performance is not on track is

overwhelming. If a chief executive is failing so too is the board. There can be reluctance to face up to that reality as well.

#### **4. has a sense of subordination to the chief executive**

Particularly in those organisations where the chief executive is the expert in what the organisation does there are many boards that have a genuine belief that the board cannot, or should not, put itself in the position of passing judgement on the chief executive's performance. This often reflects confusion about the components of the chief executive's performance that should be judged. Constitutionally, the chief executive, regardless of his or her expertise, is always subordinate to the board. The board must focus less on what the chief executive *does* (the various specialised components of his or her job) and more on what he or she *achieves*.

#### **5. wishes to avoid conflict**

A fourth and quite common reason concerns the understandable desire of most boards to have a positive working relationship with their chief executive. If it can possibly be avoided, therefore, they shy away from any hint of confrontation or conflict. No matter how collegially the board tries to operate, and whether or not the chief executive is a member of the board, the board is the chief executive's employer and must hold him or her accountable for performance.

For his or her part the chief executive:

#### **6. is concerned the board will be too tough**

Comments to us by some chief executives have suggested they believe that if their boards are less than effective in performance management, there will be less pressure on them to perform, their board will make softer (i.e. more generous) remuneration decisions and generally they will be better off.

In fact, the truth is often quite different. For example, a rigorous, objective performance management system is more likely to concentrate on the assessment of results achieved than on personality traits that cannot be objectively measured and may have little to do with on-the-job performance. An explicit and systematic process that requires a board and its chief executive to agree in advance about performance criteria also protects the chief executive against arbitrary or capricious changes in expectations or movements in the 'goal posts'. The performance of chief executives who have previously agreed clear performance expectations with their boards is less likely to be judged arbitrarily. The risk that the perceptions or the agendas of external stakeholders, or the undue influence of individual members of the board will influence such judgements, is reduced. Similarly, if there are agreed, objective assessment criteria any justly earned performance element of remuneration is less likely to be held back for 'political' reasons.

Any chief executive worth their appointment should welcome the opportunity to work with a board whose expectations are going to 'stretch' them and help them develop personally and professionally.

## **7. does not accept the board's right to judge his or her performance**

We have observed situations where the chief executive genuinely (but mistakenly) believes the mission of the organisation is far too important to be left to the mercy of the board.<sup>1</sup> He or she believes that they have to protect the organisation from a 'bunch of amateurs'. As a consequence they wittingly or unwittingly resist performance evaluation. In a sense this is the flipside of the board's own sense of subordination to the chief executive. As we have seen many times, however, even the most passive and 'weak' boards eventually come to resent being treated in this way. They have the capacity to 'bite back' usually to the considerable detriment of the chief executive.

For both the board and the chief executive together, a systematic performance management process may seem:

## **8. too much like hard work**

It is often the case that both boards and their chief executives collude to prevent effective performance management because they believe that the process will be too demanding. For example, that it will take up too much time or it will have special requirements such as the need for a separate reporting system.

Like any other organisational system, that relating to chief executive performance management should serve a useful purpose and produce a return on the resources invested. An effective performance management system can be designed that does not require undue or unproductive effort on the part of either the board or the chief executive. For example, if the focus on chief executive performance relates to organisational performance *writ large*, any additional work involved over and beyond what is usually prepared for the board will be for a specific purpose (e.g. to obtain staff or external stakeholder input).

## **Philosophy and Principles**

An effective chief executive performance management system addresses each of these barriers. When considering alternative approaches there are certain basic principles that should be the starting point. These are applicable in most organisations and constitute, in effect, a set of evaluation criteria for an effective system.

### **1. The board must do its own job first.**

The board cannot expect to hold its chief executive accountable for his or her performance until it has set performance expectations for the organisation as a whole. In its essence this means defining explicitly, and in advance:

- (a) the strategic results that the organisation must achieve, and
- (b) the boundaries that the chief executive must work within in order to avoid situations or circumstances arising which the board considers unacceptable or undesirable.

## **2. Performance expectations should be explicit and clearly understood by both the board and chief executive.**

The organisation depends to a considerable degree on the effectiveness of the chief executive who is expected to have an instrumental influence over the organisation's operations and performance. The system the board uses for managing the performance of the chief executive, the board's only direct employee, therefore represents the main source of leverage it has over organisational performance. Because the board is, for the most part, a group of part-time 'outsiders' it is not in a position to *manage* either the organisation or the chief executive. It is critical, therefore, that the board sets clear and explicit performance expectations for the chief executive, that his or her performance is subsequently monitored and that he or she is rigorously held to account for meeting the board's expectations.

## **3. The system must be 'balanced.'**

There are three ways in which 'balance' must be achieved. Firstly, an effective chief executive performance management system must strike a balance between the strict evaluation of results achieved (the *what*) and the way in which the chief executive goes about his or her job (the *how*). This is particularly important in situations (for example, in professional services firms or peak industry bodies) where the chief executive is expected to exercise rather more influence than authority.

Secondly, the board must also find a balance between the need to rigorously hold the chief executive accountable for performance while, at the same time, providing appropriate moral and other support that will allow him or her to improve their performance over time.

Thirdly, a performance management system should encourage the chief executive to seek a balance between short term (12 months or less) and longer-term objectives. It is easy for short-term matters, often overwhelmingly financial in nature, to prevail over less urgent but arguably more important matters affecting the overall interests of the organisation and its stakeholders.

## **4. An effective performance management process is two-way.**

Managing the performance of the chief executive should not be thought of simply as a 'top-down' process focussed on him or her alone. While the process should be designed to reflect the accountability the chief executive ultimately has to the board, it should also recognise that the board and the chief executive are mutually interdependent. Neither party can succeed unless the other also does an outstanding job. There is an inherent reciprocity and symbiosis in the relationship.

## **5. The performance management system must be timely and have integrity.**

Among other things this means that performance expectations must be set before, not after, the event. Once these expectations are set they must not be shifted without the knowledge and input of the chief executive. For the board this

means holding to the expectations it has set for the chief executive until such time as it is agreed these will be changed.

Because the process is continuous, feedback should be immediate. While there may well be some formal end of year review, each time the board (and individual members) 'connect' with the chief executive it is implicitly assessing his or her performance. This should be more explicitly acknowledged than it is in many organisations. For example, regular reports to the board on organisational performance can be considered part of the chief executive's performance evaluation process. Organisational achievements should be explicitly acknowledged rather than just taken for granted. Any concerns that emerge about either the organisation's or the chief executive's performance should be brought to his or her attention as soon as possible. These should not be 'saved up' until a later scheduled formal assessment is undertaken. The board, as much as the chief executive, must be committed to the 'no surprises' principle.

## **6. It must have a 'results' focus.**

As far as possible, performance expectations should be *results-based* and measurable even if only by subjective techniques like opinion surveys. Too often, however, chief executives are judged on the basis of their character traits or personality (for example, how personable or intelligent they are) rather than on what they have achieved. Concentration on attributes or traits can mask or distract from the wider reality of the chief executive's contribution to organisational performance. At best these are only a partial factor in chief executive effectiveness.

In many organisations the chief executive's job description is the only documented basis for the board's performance expectations. Because job descriptions are mainly prepared for recruitment purposes they are relatively static from one year to the next.

A job description tends to be formatted in terms of prescribed activities and tasks, thus reliance on it as a source of chief executive performance criteria creates two other problems. Firstly, it is likely to encourage the measurement of chief executive performance in terms of *activity* rather than in terms of results achieved. As a consequence monitoring and measurement can easily tend towards how *busy* the chief executive is as opposed to how *effective* he or she is. Secondly, the chief executive, without seeking further approval, is implicitly limited to listed tasks and activities that have, in effect, been 'pre-approved'. Rather than specifying *how* the chief executive should do the job, the board should define ends or results to be achieved and free the chief executive to seek the best possible 'means' to get there.

In our next issue we will examine how these considerations translate into the design of an ideal chief executive performance management process.

1 "Using the board's expertise" Good Governance #10, July-August 1999