



Board Evaluations: Insights from India and Beyond

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Contents

Foreword 2

Introduction..... 5

II. Reasons for Board Evaluation 6

III. Situation Varies Worldwide 7

IV. Requirements in India..... 11

V. Understanding the Challenges 13

VI. Case Example from India..... 15

VII. International Trends..... 17

VIII. Looking Ahead..... 22

References..... 24



FOREWORD

The recent promulgation of Indian Companies Act, 2013, and amendments introduced by the Securities and Exchange Board of India (SEBI) to Clauses 35B and 49 in response in April 2014, has considerably raised the bar for corporate governance in Indian companies. The revised regulations put strong emphasis on internal financial controls, risk management, and Board oversight. The role of the independent director has been further strengthened to make it more objective and purposeful.

What is interesting to note is that the requirement for a Board evaluation has been made mandatory for every listed company and other public company with a paid-up capital of Rs 25 crore or more (approximately US\$ 4 million).

Are companies in India ready to face the challenge of effective implementation of an effective and productive Board evaluation process? What are the global best practices, and what are some of challenges and resistance and how these can be overcome? What are some of the issues and considerations likely to be generated by Board evaluations? Mary Jo Larson and Chris Pierce write about Board evaluation, the logic behind this concept, the benefits of such a process, and the extent to which it can be deployed in a productive manner by Boards. They illustrate their points of view by using examples from India employing experience they have gained over the years working extensively with and for a number of prominent Indian companies, including the Tata Group. They emphasize the role of the chair in providing valuable leadership, the necessity for establishing standards and benchmarks, engaging other senior leaders and providing legitimacy to the entire process in making it a useful and productive exercise that can be meaningfully undertaken by Boards. The success and usefulness of the Board evaluation will depend to a considerable extent on the genuine commitment demonstrated by the chair.

The analysis and insights provided by Mary Jo and Chris in using third party experts well versed in the Board evaluations to assist in the evaluation process and involving other stakeholders to solicit feedback is instructive and timely. Their thoughts and guidance are offered as a practical guidance in implementing an effective Board evaluation process and is not intended to be a comprehensive analysis of all the different components that comprise an effective process, but highlight the key constituents that warrant consideration before embarking on the process.

With the efforts made by regulators to avoid another Satyam incident through the introduction of various reforms, the challenges for India remain in implementation and enforcement. For the companies, they need to follow corporate

governance practices not just in letter but also in spirit. Board evaluation will need to be taken seriously and the recommendations be looked at as areas for improvement rather than as criticism. In other words, make it a constructive process. Efforts should be made to avoid it being just a box-ticking exercise, especially regarding performance of independent directors, who need to be more aware of their role. Ensure that the process is value-accretive and provides strategic guidance; ensure that it is seeking to identify areas that will genuinely enhance the Board's performance collectively and the effective contributions of its directors individually. It should not be used as a witch hunt.

In a recent survey by McKinsey of Boards around the world, it was revealed that of the 772 directors surveyed only 34% indicated that they "fully comprehended" their companies' strategies. Even more alarming was the indication that only 22% stated their Boards were "completely aware" of how their firms created value and an even fewer 16% of the directors surveyed indicated that their Boards had a "strong understanding" of the dynamics of their firms' industries [Where Boards Fall Short, Dominic Barton and Mark Wiseman, Harvard Business Review, January 2015].

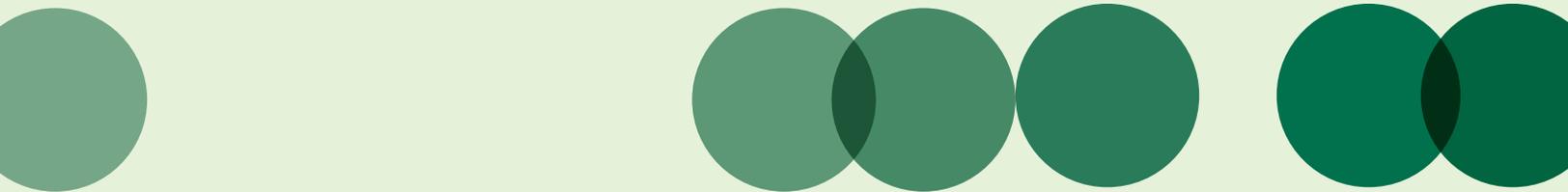
An effective Board evaluation process would seek to tease out this sort of information and which would alert the Board chair that he or she has some work on their hands. The key for any Board is that it adds value to management's deliberations in determining strategy and the critical thinking which lends itself to a solutions driven decision-making process.

The driver for successful corporate governance implementation is the Board's desire to conform, improve, and perform, in line with the true spirit of corporate governance reform. Mary Jo and Chris's study is a welcome contribution to a better understanding of the influencing factors of Board evaluation, on the challenges, and how to address these challenges to get the Board from a routine, process driven focus to one that is consciously performance driven in supporting value-driven decisions.

A handwritten signature in black ink that reads "Phil Armstrong". The signature is written in a cursive, flowing style with a long horizontal stroke at the bottom.

Senior Advisor: Corporate Governance
Corporate Governance Group
International Finance Corporation

“The world’s economic center of gravity has continued shifting from West to East...”¹



¹ Dobbs, R., Ramaswamy, S., Stephenson, E. and S. P. Viguerie (2014)

I. INTRODUCTION

Board evaluation has emerged as a corporate governance priority and brought to the forefront many associated challenges. This is not a revolutionary change. Board assessment procedures are evolving as nations and companies formulate and test diverse requirements. In India, for example, the Companies Act of 2013 mandates that the code of conduct for independent directors include: “Bring an objective view in the evaluation of the performance of Board and management.”

Until recently effective Board evaluation was not regarded a Board priority. In 2002, Yale University Professor Jeffrey Sonnenfeld commented: “I can’t think of a single work group whose performance gets assessed less rigorously than corporate Boards.”

However, in the last 12 years the situation has substantially changed. Corporate governance practitioners have been applying Peter Drucker’s idea that “what gets measured gets managed,” and among senior leaders, what gets acknowledged and valued gets done even better.

India has moved to the forefront of this governance challenge with its new Companies Act of 2013, which states that the Board of every listed company and other public companies with paid-up capital of Rs 25 crore or more (approximately US\$ 4 million) shall report the annual performance evaluation of individual directors, the Board and its committees.²

Amendments made by the Securities and Exchange Board of India (SEBI) to Clauses 35B and 49 of the Equity Listing Agreement issued in April 2014 mention “Monitoring and reviewing Board Evaluation framework” as a key function of the Board.³

In the following pages, we examine features of Board evaluation and the challenges now facing Boards in India and beyond. “Board evaluation” is a term that commonly refers to the assessment of the Board as a whole, its committees and its individual members. At this stage, companies in India tend to emphasize the evaluation of the Board as a whole, and this article reflects that situation.

Recognizing the merits of various approaches, we highlight the Board’s leadership culture – *the tone at the top* – as an essential feature of an effective assessment process. As described below, Board evaluation is driven by the values and performance expectations of senior leaders in Tata Group, Infosys and other well-known Indian companies.

Topics addressed in this article include:

- Incentives for Board evaluation
- Extent of Board evaluation globally
- Significant requirements in India
- Predictable barriers and challenges
- Case example of Board leadership from India
- Recommended practices worldwide
- Future trends and challenges

² Section 134(3)(p) of the Companies Act (2013)

³ Clause 49 Amendment (2014)

II. REASONS FOR BOARD EVALUATION

“If the chair and the Board perceive Board evaluation as an opportunity to get the Board to think smarter and work more effectively, Board evaluation can achieve great things!”⁴

What are the incentives for Board evaluation? This section recognizes the pressures associated with regulatory and investor requirements. Equally if not more significant are senior leaders’ standards of excellence and their determination to strengthen the leadership culture and performance of the Board.

1. Compliance with legal requirements

There is a global trend toward mandatory provisions made by regulatory bodies such as stock exchanges, central banks and financial services commissions. The Ministry of Corporate Affairs, which has the responsibility to administer India’s Companies Act (2013), now mandates the annual reporting of Board evaluations for designated companies.

2. Investor and shareowner pressures

Board evaluation is increasingly used to demonstrate to investors the commitment to improving performance at the highest levels. Institutional investors consider Board evaluation a significant criterion in their governance ratings of companies. In the near future institutional investors are likely to be requesting Board evaluation reports (including a description of the process and a summary of the Board development plan arising from the evaluation) in the Annual Report to shareholders. Positive results from Board evaluations signal to shareholders and key stakeholders that the company is well governed. When the Board is able to demonstrate an ethical culture and effective practices, the evaluation process raises the profile and reputation of the Chairperson, senior leaders and the company as a whole.

3. To improve leadership and performance

The Chairperson of Infosys was among the first to champion the benefits of Board evaluation. Senior leaders at Tata Group,⁵ a global enterprise headquartered in India, have developed a business excellence model

for the regular, systematic assessment of leadership systems, including Board governance. The assessment framework reinforces Tata’s values, ethical behaviors and performance expectations. The *Leadership* category includes mechanisms for senior leaders to conduct self-examination, receive feedback, and improve.⁶ Studies in Europe⁷ and the US⁸ confirm that when senior leaders take ownership of the Board assessment process, their meetings proceed more smoothly, they make better decisions, and they have greater influence on long-term corporate strategy.

Benefits of engaging the Board include:

- *Improved decision-making* – In many cases, the assessment process leads the Board to reconsider Board practices, including priorities on the agenda and the efficiency of its communication systems and information architecture. The process of raising directors’ concerns acts as an early warning system to the Board, which will allow changes to be implemented before more deep-rooted problems set in.
- *Improved performance* – Board and individual effectiveness improves as a result of developmental assessment. Improvements in Board practices and structures help to improve trust, respect and business confidence. Significant results may be recognized through corporate governance and Board leadership awards.
- *Improved accountability* – Board evaluation is a major method for a company to improve its accountability, transparency and disclosure. Positive results of ‘Board evaluation’ can be included in Annual Reports, which allow the Board to frame and provide evidence of the value it creates for the company and beyond.

4 Chairperson of a non-listed UK company

5 Founded in 1868, Tata group is global enterprise comprised of over 100 operating companies. See: http://www.tata.com/aboutus/sub_index/Leadership-with-trust

6 Tata’s Business Excellence Model (TBEM)

7 Van den Berghe and Levrau (2013)

8 Conger (2009)

III. SITUATION VARIES WORLDWIDE

“Approaches to evaluation are very diverse and there is little clarity and consistency on what constitutes an effective evaluation.”⁹

There is no global approach or model for Board evaluation. In some countries, such as the UK, the USA and India, Board evaluations are now mandatory for specified listed and public companies. In most countries, Board evaluation is a recommended practice. Within those countries conducting Board evaluations, priorities are influenced by regulatory requirements and leadership preferences. Much of the focus in US companies is upon how the Board deals with oversight of internal controls with particular reference to Sarbanes-Oxley (2002) requirements. Many of the UK companies are focusing upon Board behaviors.

Australia (2014¹⁰)

Listed companies should disclose the process for evaluating the performance of the Board, its committees and individual directors and should disclose, in relation to each reporting period, whether a performance evaluation was undertaken in the reporting period in accordance with that process. The Australian Stock Exchange (ASX) states that “it is essential that the Board has in place a formal and rigorous process for regularly reviewing the performance of the Board, its committees and individual directors and addressing any issues that may emerge from that review.” The ASX recommends that the Board should consider periodically using external facilitators to conduct its performance reviews. The Stock Exchange also recommends that when a listed company discloses whether a performance evaluation has been undertaken the entity should, where appropriate, also disclose any insights it has gained from the evaluation and any governance changes it has made as a result.

South Africa (2009¹¹)

The King 3 Report states that the evaluation of the Board, its committees and the individual directors should be performed every year. The Institute of Directors in

Southern Africa has undertaken over 80 Board evaluations since the publication of the King 3 Report in 2009 and has identified that Board evaluations are associated with:

- Assisting Boards in assessing how well they have performed through benchmarking their performance against established best practice
- Allowing for reflection on the role of the Board, what its objectives are and how it has fulfilled those objectives
- Creating the opportunity for enhancing Board effectiveness
- Informing the recruitment and appointment of directors
- Providing a basis for identifying future development needs of the Board

United Kingdom (2014¹²)

The Board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. The UK Code of Corporate Governance requires large companies to have a Board evaluation undertaken by an external independent evaluator at least every three years.

The Financial Reporting Council (FRC)¹³ encourages companies to disclose the main actions that were agreed following the Board effectiveness review and, where relevant, how those actions identified in previous years had been implemented. The FRC does not wish to be prescriptive and believes this approach potentially enables Boards to demonstrate to shareholders how they are working to improve their effectiveness in a way that does not require them to disclose sensitive information.

9 Armstrong (2014)

10 Australian Stock Exchange (2014)

11 King (2009)

12 The UK Code of Corporate Governance (2014)

13 FRC (2013)

In the UK it is becoming increasingly common for companies to provide at least some information on what actions will be taken as a result of the review. A survey in 2013¹⁴ found that 56 per cent of FTSE 100 companies and 32 per cent of FTSE 250 companies disclosed outcomes of their evaluation in 2013, up from 44 and 30 per cent respectively in the previous year.

United States¹⁵

Under New York Stock Exchange (NYSE) listing rules, the charters of the audit, compensation and nominating/corporate governance committees of domestic listed companies are required to provide for annual performance evaluations of these committees. In addition, the NYSE listing rules require domestic listed companies' Boards to address annual performance evaluation in their corporate governance guidelines.

A survey in 2012¹⁶ identified that 92% of survey respondents conducted full Board evaluations, 83% conduct committee evaluations, and 48% conduct individual director evaluations. Another survey¹⁷ in the same year identified that

14 Grant Thornton (2013)

15 New York Stock Exchange Listing Rules

16 NACD (2012)

17 Spencer Stuart (2012)

only 2% of S&P 500 Boards (versus 10% in 2008) did not conduct some kind of annual performance evaluation. More than 50% of those that did undertake annual evaluations examined both the full Board and individual committees, 13% evaluated only the full Board and 31% (up from 29% in 2011) reviewed performance of the full Board, committees and individual directors.

Saudi Arabia (2014¹⁸)

The Saudi Arabian Monetary Agency requires that the Boards of all banks operating in Saudi Arabia shall carry out, on a periodical basis, regular assessment of both the Board members as a whole and of the individual Board members. The Agency requires that bank Boards should periodically review the effectiveness of its own controls and work procedures and identify weak points and make any necessary changes whenever the need arises. The Agency recognizes that entrusting an external entity to carry out a Board assessment can contribute to the objectivity of the process.

Spain (2005¹⁹)

The Principles of Good Corporate Governance for Unlisted Companies in Spain recommends that the Boards of

18 SAMA (2014)

19 ICA (2005)

A recent survey (2014) identified that:



Source: Heidrick and Struggles (2014)

all unlisted companies should periodically assess its performance, its directors' performance and Board committees' performance (if any). The Board should also make an annual evaluation of its chief executive and this evaluation should be coordinated by the non-executive Chairperson (or by the senior independent director/lead director/principal director when the Chairperson is an executive) who will subsequently submit the results to the chief executive.

Approaches to Board evaluation are also influenced by sector requirements, ownership structures, and the role expectations of senior leaders.

- **Different sectors**

Different sectors tend to differ in their priorities. Board evaluations in the public sector often focus upon the Board's oversight of service provisions to key stakeholders (e.g. value for money audits), which often have a current or historical orientation. Board evaluations in the private sector tend to focus upon the Board's performance with an eye on value creation and its involvement in

management oversight, with present and future orientations.

- **Different ownership structures**

Different ownership structures also tend to differ in approaches to Board evaluation. Companies with a widely dispersed ownership structure tend to focus upon the Board's reporting to shareholders, which often has a current or historical orientation. Companies with a highly concentrated ownership structures often focus upon the Board's treatment of related party transactions, abuse of minority shareholder interests, conflicts of interests, and other business issues.

- **Role definitions and expectations**

It is interesting to note from a 2014 survey of opinions among European Listed Companies (Table 1), that only 41% of Board members and 30% of CEOs believe that it is the Chairperson's job to lead Board evaluation among listed companies in Europe. In fact, only 4% of Chairpersons perceive it as their responsibility.

Table 1: Survey of Board, Chairpersons and CEOs of European Listed Companies

WHO LEADS THE EVALUATION?	RESPONSES FROM BOARD	RESPONSES FROM CHAIRPERSONS	RESPONSES FROM CEOs
The Chairperson	41%	4%	30%
A committee	13	12	18
Senior/Lead Independent director	4	14	3
Board members	33	53	52
External consultant/facilitator	17	11	5
Other	4	5	5
No one/not applicable	5	11	6

Source: Heidrick and Struggles (2014)

Increasingly, companies are amending their terms of reference and committee charters to incorporate Board evaluation and define roles for this additional responsibility. For example, the 2013 – 2014 annual report of Dr. Reddy's Laboratories Limited states:

*"The Nomination, Governance and Compensation Committee periodically oversee an evaluation of the Board, and recommend desirable changes in Board size, composition, committee structure and processes, and other aspects of the Board's functioning."*²⁰

Nomination, governance and remuneration committees can play a key role in organizing the design, presenting Board strengths and gaps, and linking the performance review to the Board's strategic responsibilities.

Recent surveys also indicate that there is an increased use of external advisors and evaluators.²¹

- 21% of European listed companies use external consultants/facilitators every year
- 10% use them once every two years
- 36% use them once every 3 years or less often
- 33% never use one

An experienced evaluator/advisor should be able to adapt and design Board evaluation to meet these different circumstances and contexts.

²⁰ Dr. Reddy's Laboratories Limited, Nomination, Governance and Compensation Committee Charter (<http://www.drreddys.com/investors/pdf/charters/charter-compensation-comm.pdf>)

²¹ Heidrick and Struggles (2014)

IV. REQUIREMENTS IN INDIA

The Ministry of Corporate Affairs²² regulates corporate governance in India through the Companies Act of 1956 and the Companies Act of 2013. Strengthening director's independence is a distinctive governance priority in the Companies Act of 2013.

Board composition

Companies in India must now have at least one-third of the Board as independent directors. Also, for public and private firms with an annual turnover of at least three billion rupees (approximately US\$50 million), one female director is mandatory.

Board performance

A director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.²³ The financial expertise required of directors has been increased with the reporting of consolidated financial statements and depreciation methods having been much altered.

Legal duties and responsibilities of directors

Independent directors are now liable for acts or omissions that occurred with their knowledge, attributable through Board processes, and with consent or connivance or where the independent director had not acted diligently.

Governance structures

The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority.²⁴ Also, the role of the Audit Committee has been tightened and new rules concerning auditor appointment and rotation have been introduced.

The Nomination and Remuneration Committee²⁵ shall consist of three or more non-executive directors out of which not less than one-half shall be independent directors. The Board Chairperson may be appointed as a member of this committee but shall not chair the Committee. This Committee formulates the criteria for determining qualifications, positive attributes

and independence of a director and recommends remuneration packages.

Many Indian companies are now required to have a Corporate Social Responsibility (CSR) committee with a specified committee mandate.

Board evaluation

The Board's Nomination and Remuneration Committee has the responsibility to carry out the evaluation of each director's performance. The annual Board of Directors' report to the general meeting shall include the results of the formal evaluation with a statement indicating the manner in which the Board conducts the formal evaluation of the Board's performance, the Committees' performance, and the performance of individual directors.

The Companies Act of 2013 now mandates that independent directors be evaluated against the *Code for Independent Directors*. Independent directors assume significant duties and responsibilities, as summarized below.

SEBI puts special emphasis on the performance evaluation of independent directors, to the extent that the decision to extend or continue the term of appointment of independent directors should be based on their performance evaluation report. SEBI also outlines the role of the Nomination and Remuneration Committee to formulate criteria for evaluation of the independent director and the Board and the evaluation criteria needs to be disclosed in the Annual Report.²⁶

SEBI issued a Circular (2014) that expands the role of the independent director in the amendments made to Clause 49. The amendment requires independent directors to have at least one meeting a year without the attendance of non-independent directors and members of management where the performance evaluation of the non-independent directors will be made.²⁷ This addition is the main difference between the Companies Act of 2013 relating to Board evaluation and Clause 49. SEBI's amendment to Clause 49 stipulates that:

²² <http://www.mca.gov.in/>

²³ Section 166 (3) Duties of Directors of the Companies Act (2013)

²⁴ Section 177 of the Companies Act (2013)

²⁵ Section 178 of the Companies Act (2013)

²⁶ Clause 49 Amendment (2014)

²⁷ Clause 49, section 6, Part B

“The independent directors in the meeting shall, inter-alia:

- i. Review the performance of non-independent directors and the Board as a whole;*
- ii. Review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;*
- iii. Assess the quality, quantity and timeliness of flow of information between the company*

management and the Board that is necessary for the Board to effectively and reasonably perform their duties.”

The new requirements are designed to strengthen corporate governance structures and the performance of legal and fiduciary duties. However, regulators have not provided guidance on how to undertake the evaluation process, giving the companies in India flexibility in choosing a process that’s appropriate for them.

Table 2: Code for Independent Directors in India

DETAILED GUIDELINES FOR PROFESSIONAL CONDUCT, ROLES AND RESPONSIBILITIES INCLUDE:

- Upholding ethical standards of integrity and probity;
- Acting objectively and constructively while exercising director duties;
- Exercising responsibilities in the interest of the company;
- Devoting sufficient time and attention to professional obligations for informed and balanced decision making;
- Not allowing any considerations to vitiate objectivity and independent judgment;
- Not abusing position to the detriment of the company or its shareholders or for personal advantage;
- Bringing an objective view in the evaluation of the performance of Board and management;
- Safeguarding the interests of all stakeholders, particularly the minority shareholders;
- Undertaking induction and regularly updating and refreshing skills, knowledge and familiarity with the company;
- Keeping well informed about the company and the external environment;
- Satisfying themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible;
- Seeking appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice and opinion of outside experts;
- Paying sufficient attention and ensure that adequate deliberations are held before approving related party transactions and be assured that they are in the interest of the company;
- Reporting concerns about unethical behaviour, actual or suspected fraud or violation of the company’s code of conduct or ethics policy.

Source: Schedule IV. The Companies Act (2013)

V. UNDERSTANDING THE CHALLENGES

“Boards have to want to change. And many Boards are working very hard to avoid it.”²⁸

According to an informal survey of corporate governance professionals representing more than 42 countries²⁹, directors continue to approach ‘Board evaluation’ with caution and resistance. A recent study in Belgium³⁰ revealed that the requirement for periodic Board evaluation is one of the least respected governance recommendations.

What are the barriers and challenges? To begin, Board evaluation is not a familiar international practice. Most of the countries at the forefront of governance change have only introduced Board evaluation in the last 12 years.

There are predictable reasons why performance evaluations do not take place or are ineffective. Patterns of resistance include three barriers: defensive attitudes, legal and procedural concerns, and perceived business risks.

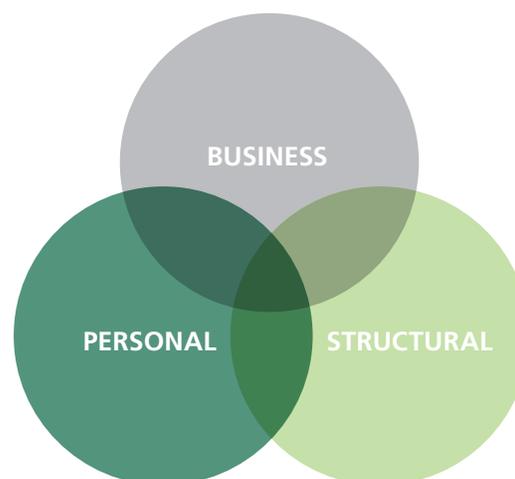
Personal (‘mindsets’ or attitudes, egos, status, reputations, relationships, competence)

Structural (rules and regulations, bylaws, authority roles, procedures, policies, laws, acts, rules)

Business (strategy, investments, costs, shareowner value, conflicts of interest)

These factors are interrelated, as indicated in Figure 1. For example, personal animosity, especially within family-founded firms, may undermine Board deliberations, reporting procedures, and business decisions. When the assessment reveals a business risk, the Board needs to identify the root of the problem. Is it *personal* (including incompetence, ethical violations), or *structural* (ineffective procedures, policies, etc.)? The way the problem is defined sets the stage for remedial action.

Figure 1: Board Challenges



Personal

Attitudes are the first and greatest challenge, particularly when ‘mindsets’ include indifference or inflexibility – unwillingness to change. The duty to exercise independent judgment also poses distinct challenges. Many directors prefer to go along with the majority (“group think”) to get along.

Directors who have served with the same Board members over an extended period of time may be uncomfortable judging or being judged by colleagues. They are accustomed to evaluating the CEO and other senior executives, but when asked to engage in Board evaluation, they raise a wide range of objections.

Some argue that it is impossible to establish objective criteria concerning a director’s skill, experience and attributes. A common claim is that directors have established track records and reputations, and they do not need to “prove” themselves any further. Directors may also fear that the evaluation results will be used against them, particularly if they lack IT, financial or other technical expertise.

28 Korn Ferry (2011)

29 IFC’s Global Institute of Directors Meeting and Consultation. May 2014. Istanbul, Turkey.

30 Van den Berghe L and Levrau A. (2013)

One technique for reducing directors' opposition to an "evaluation" is to recast them as "performance enhancement plans" (PEPs). The focus of the process is to enhance the Board's performance rather than criticize behavior. Treating reviews as a forward-looking planning process re-frames the exercise as goal-oriented and positive.

Structural concerns

There is little clarity about what constitutes a proper evaluation procedure. Board members have questions about the reasons, their roles, the rules and the potential impact on relationships and remuneration. Questions include: Who are the right people to lead the evaluation? What is the right process? Which information to gather? How is the data analyzed and reported? How is confidentiality enforced? What is the benchmark?

In India, the Companies Act of 2013 requires independent directors to assume significant Board evaluation responsibilities. Independent director duties include bringing an objective view in the evaluation of the performance of Board and management. These directors hold significant positions on the Nomination and Remuneration Committee, which has the responsibility to carry out the evaluation of every director's performance.

Board evaluation responsibilities may pose dilemmas and risks for independent directors, as their re-appointment as Board members depends upon the report of their

performance in the evaluation. An independent director who has concerns about actual or suspected business fraud must weigh the potential consequences of reporting such concerns, including the possibility that re-appointment to the Board will be denied.

The Chairperson has a duty to ensure that independent director contributions are valued and fairly assessed, particularly when perceived or actual Board violations are revealed through the evaluation process.

Business concerns

The assessment may reveal questionable transactions, inappropriate loans, or concerns about the fairness of remuneration packages (annual, per meeting fees, etc.). Highly sensitive business concerns include related party transactions and perceived conflicts of interest, which give undue advantages to Board members, their relatives or associates. A comprehensive evaluation also addresses strategic, financial, IT, safety and environmental responsibilities.

Business issues do come to the surface. The manner and extent to which the Board investigates such issues is strongly influenced by the Board's leadership culture. The Chairperson plays a crucial role, ensuring that Board evaluation has legitimacy and that it is being undertaken with authority and fairness. As noted by IFC's Phil Armstrong: "If the Chairperson is not committed or waivers at a critical point, the whole thing will likely fail!"

VI. CASE EXAMPLE FROM INDIA³¹

“Only a forward looking Chairman, who is prepared to move out of his comfort zone and get the whole Board to commit energy and resources, can help raise the Board’s performance bar. In this context, Board evaluation becomes a powerful instrument to help companies to step back and take a closer look at their performance.”³²

This section describes a Board evaluation conducted by Rallis India Limited in 2008. The Chairman, Mr. R. Gopalakrishnan, initiated the informal self-assessment process to identify “areas of improvement for greater engagement between the Board and management.” This case analysis illustrates the Chairperson’s leadership role, how the evaluation process was tailored for this Board, and the significance of the Board’s culture – “the ecology in the Boardroom.”

Steps in the Rallis Board evaluation process:

Preparation: The Chairman had considerable experience serving on the Boards of other companies. He was aware of effective practices and wanted to use a self-evaluation process to determine how the Rallis Board could become more effective. The Chairman considered Board dynamics and relations with management before launching this exercise.

- *Board dynamics* – the Boardroom atmosphere was conducive to open, productive deliberations. The Chairman made sure that all directors had an opportunity to contribute, and the directors were able to express candid opinions.
- *Relations with management* – the level of engagement between Board members and management was high. In preparation, the Chairman made sure that the CEO understood and was comfortable as an active participant in the evaluation process.

Orientation: In March 2008, during a Rallis Board meeting, the Chairman announced that the timing was right to “step back and take a look at ourselves and determine how we have done and what are the areas we still need to improve.” Directors were told that the Chairman would send each an email requesting their views.

Implementation: After the report of the 2007-2008 financial results, the Chairman sent a personal email to all directors. The Chairman asked that all directors send to him, confidentially, their views on (1) the functioning of the Board, and (2) suggestions for improvement. In addition, the Chairman asked the CEO, Mr. Shankar, to capture management’s views of the Board’s performance. The CEO surveyed 10 managers (in a meeting) and used a questionnaire to gather data for statistical analysis. Findings were analyzed and sent to the Chairman.

Analysis: The Chairman analyzed the comments from directors and the summary findings from management. He divided his report into two sections, one with director responses and the other from management. Both included “Positives” and “Suggested Areas of Improvement.” In May 2008, the Chairman reported the summary of findings to the Board of Directors immediately after the Annual General Meeting. The CEO attended and took notes at the meeting. In-depth discussions resulted in action points to improve Board practices, financial oversight, and the Board’s involvement in strategy formulation.

Follow up: In July 2008, the action points were presented to the Board. The follow-up plan included placing the action points on every Board meeting agenda. As a result, recommended actions have helped to improve the functioning of the Board and the engagement between the Board and management.

The Chairman played a vital leadership role in this Board’s self-evaluation. Board members and senior managers responded to the exercise with confidence in his objectives and intentions. According to Mr. E.A. Kshirsagar, a non-executive director on the Board, the Chairman was the main reason that all Board members could give their views freely...³³

31 Kar and TMTC Team (2009). The authors wish to acknowledge and express their gratitude to Pratip Kar and TMTC team for making this detailed Board evaluation case analysis available.

32 Kar and TMTC Team (2009)

33 Kar and TMTC team (2009)

Table 3: Examples of areas of improvement and action proposed for greater engagement between Board and management

AREAS FOR IMPROVEMENT	ACTION PROPOSED
Minutes to be circulated more promptly after the Board meeting	Draft to be sent to the Chairperson within three days and emailed to others after approval
Give more authority to the CEO and other senior managers	CEO to identify areas where this can be done, e.g. in routine operational approvals subject to statutory requirements
Audit Committee meet without CEO	CEO to stay out of at least one meeting during the year; Audit Committee may have some time separately with the Chief Auditor or CFO in any of the meetings
Annual Strategy meeting with the Board	CEO will organize annual strategy meeting with both Board members and executive committee members
Audit on corporate responsibilities (environment, health and safety)	CEO will organize the audit

VII. INTERNATIONAL TRENDS

“Defining governance and Board effectiveness is not a straightforward exercise.”³⁴

The Rallis case is not intended as a model that will fulfill all company or regulatory requirements. The Board’s self-assessment was tailored for a specific stage in the Board’s renewal to address specific company priorities. The Chairperson launched the evaluation as the company began to improve its performance. Significantly: “the Board continues to conduct the evaluation exercise even now when the company continues to do well.”³⁵

The strengths of the Rallis case example are worth repeating:

- Confidence and trust in the Chairperson’s leadership
- Candor and trust among Board members
- Inclusion of all senior leaders (Board and management)
- Commitment to improve Board performance and engagement with management

Typically, as the Board continues to strengthen governance skills and structures, more formalized evaluation systems evolve. They include the Board performance, the Committees’ performance, and the performance of each director.

What gets assessed?

Board evaluation systems will focus attention on specific corporate governance categories, including:

- *Board leadership* – Chairperson’s approach; Board culture (principled, independent minded); inclusion in deliberations and decision making, etc.
- *Board structure* – Appropriate number and types of committees; reporting lines between the Board and management, etc.
- *Board composition* – Size, mix of skills, relevant experience; attributes (diversity, independence); selection process, etc.

- *Company strategy* – Board’s understanding, contributions and oversight
- *Financial oversight and management reporting* – Right information, appropriate tools, key risk indicators
- *Board practices* – Board meeting frequency, agendas, efficiency, minutes, etc.
- *Board development* – Evaluation of senior leaders (CEO, directors), succession planning, professional development opportunities

More simply stated, the following elements contribute to Board effectiveness :

- The right structures
- The right people
- The right issues
- The right process
- The right culture
- The right information
- The right remuneration
- The right follow through

Walton (2014) observes that Board evaluations tend to be either people focused or task focused. People-focused Board evaluations can shape Board leader roles, build insights, create openness (address ‘the elephant in the room’ or ‘undiscussability’), enhance development, and strengthen team effectiveness. Task-focused Board evaluations can facilitate compliance, help achieve systems improvements, and send a message to key shareholders and stakeholders.

Senior managers in India caution that the focus on tasks must reinforce distinctions between director and manager roles. Directors provide strategic leadership. They have oversight responsibilities (strategy, finance, compliance,

³⁴ Van den Berghe and Levrau (2013)

³⁵ Update from Pratip Kar (2014)

Sample Document Request

- Board charter
- Code of ethics
- Organization chart of Board and committees
- Biographies and status of directors e.g. nominees
- Latest Annual Report
- Agendas of Board meetings for last year
- Attendance at board meetings for last year
- Minutes of Board meetings for last year
- Terms of reference of all committees
- AGM agenda and minutes
- Induction policy
- Related party policy
- Communication policy
- Details of off balance sheet policy
- Other policies including conflicts
- Risk policy, risk assessment register, risk registers
- IFRS application details
- Internal audit reports
- Management letter from external auditors
- Company secretary job description
- Chairperson's job description
- Anticipated retirements/ succession plans

etc.) – not direct control of operations. The concern: “Directors may get into high gear and into management... there is a very thin line between directing and managing.”

Who leads the evaluation process?

The Chairperson plays a vital leadership role, establishing the spirit of inquiry and standards for a process that engages all senior leaders. Confidence in the Chairperson encourages directors and senior managers to freely contribute their observations, concerns and recommendations.

Increasingly, a trusted third party (such as a corporate governance specialist) assists in the evaluation process, providing guidance for an approach that is efficient, constructive, confidential and implemented fairly, as planned.

In India and other countries, depending on regulator requirements, the Nomination and Remuneration Committees (primarily independent directors³⁶) are required to carry out the formal evaluation of every director's performance.

In some companies, the company secretary provides technical support. If the Board is concerned about the quality of the Board's papers, it is clearly inappropriate for the company secretary to administer the process.

Good practice recommends an impartial third party advisor, since the Chairperson and the company secretary role and functions are part of the performance assessment and they are therefore conflicted in terms of objectivity. The third party advisor or consultant must sign a non-disclosure agreement.

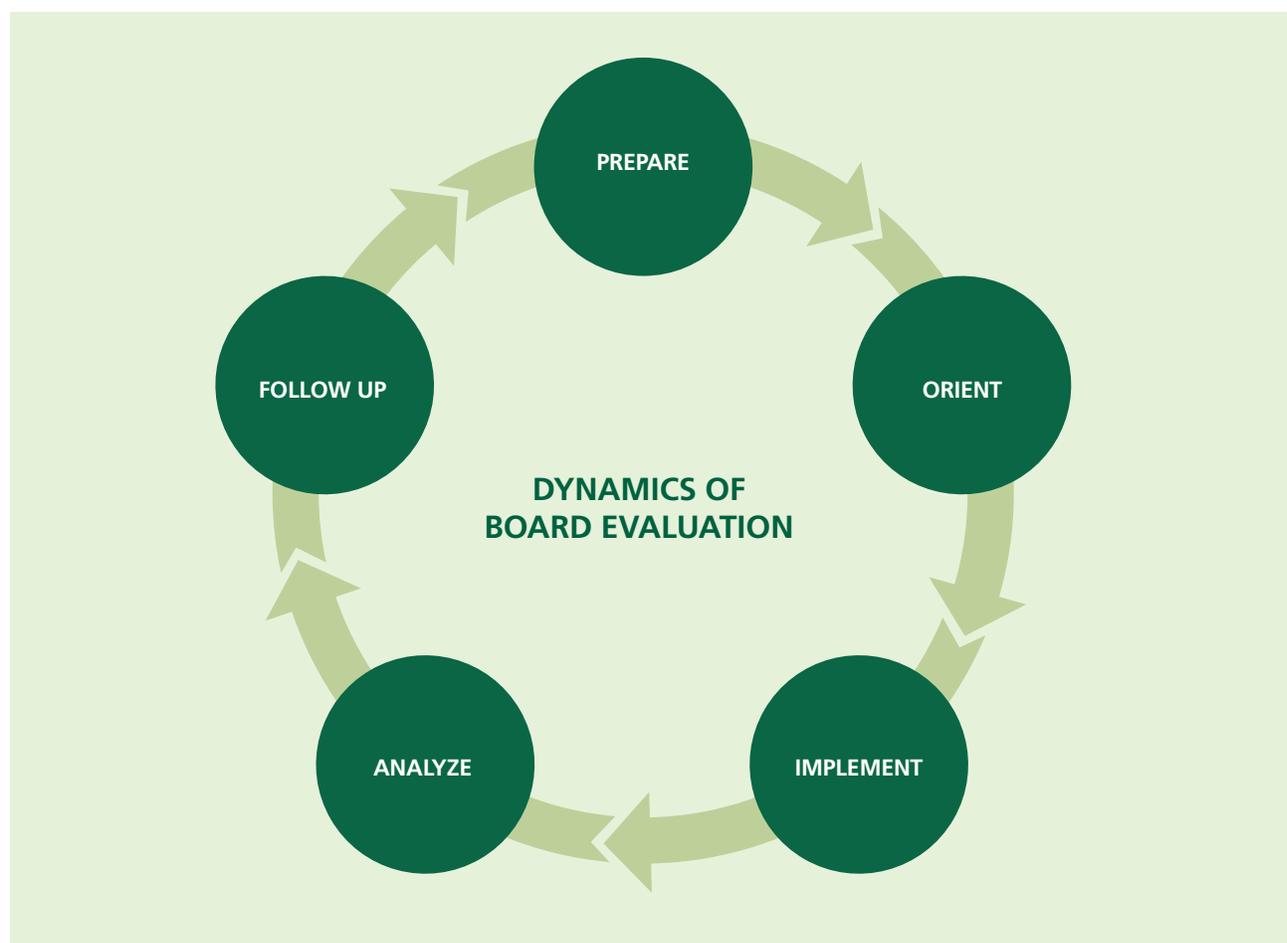
Steps in the evaluation process?

Board evaluation typically involves the following steps:

- **Prepare** with the Chairperson
- **Orient** senior leaders
- **Implement** a confidential process
- **Analyze** findings, prepare report
- **Follow up** with remedial and development plans

³⁶ Recall that in India, in designated companies, the Nomination and Remuneration Committee shall consist of three or more non-executive directors out of which not less than one-half shall be independent directors.

Figure 2: Steps in Board Evaluation



1. **Preparation:** Working with the Chairperson, determine objectives, procedures, roles and responsibilities. Draft the performance assessment instrument(s), which may include questionnaires and one-to-one confidential interviews.

Good timing is essential. Ideally, the Board's performance assessment will take place prior to the annual off-site strategy meeting. At some point during the latter part of the strategy meeting, the Chairperson can then devote appropriate time for the discussion of the Board's performance and the skills and expertise required to move the strategy forward. As noted by Elise Walton: "...Board assessments are not independent or separate from strategy work or the basic business of the Board; they can be and are an essential supplement to that work."³⁷

2. **Orientation:** Meet with Board members to review and finalize the assessment instruments. It is essential that the Board members understand, in advance, on what basis they will be assessed. During the orientation:
 - The Chairperson speaks as a 'champion' for the evaluation process – valuing candor and emphasizing the forward-looking benefits.
 - Relate the assessment process and objectives to the formal descriptions of what the Board of Directors are officially expected to do, including role definitions defined in the company's constitution (the memorandum and articles of association and By laws); Board mandate or charter, terms of reference and schedule of reserved powers; Terms of reference and Board committee mandates; Role of the non-executive directors as defined in their letters of appointment.
 - Describe the content, procedures and performance metrics (e.g., rating scale).

37 Walton (2014)

The orientation meeting is an opportunity to build confidence in the scope, objectives and benefits of the Board evaluation process. Following the orientation, with the Chairperson’s approval, make recommended adjustments.

3. **Implementation:** Elicit observations, questions and recommendations from all senior leaders (Board and management). The confidential process may include:
 - A questionnaire being completed individually and privately by directors, including open-ended questions; and
 - Confidential interviews on a one-to-one basis being undertaken with discussions focusing upon issues raised in the questionnaire.

Typical areas of review include Board composition, structure and practices; strategy and financial oversight; quality and precision of management

reports and reporting; the control environment: relationships with shareholders and key stakeholders; and commitment to corporate governance. Through open-ended questions, consider the candor and trust among Board members, and the performance of the Board as a whole. Maintain strict confidentiality at all times.

Choosing the right methodology is critical, it is also critical to determine and identify appropriate criteria for Board evaluation. The performance matrix and procedure for Board evaluation depends on the type of organization and objective of the evaluation. Many companies choose to do this only to fulfill regulatory requirements.

The objective of Board evaluation should certainly not only be to achieve compliance with stock exchange requirements; it should be to enhance Board

Figure 3: Example of Board composition question and rating scale:

	NEEDS MAJOR IMPROVEMENT	NEEDS IMPROVEMENT	APPROPRIATE	VERY APPROPRIATE
MIX OF SKILLS, EXPERTISE	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
GENDER	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
BACKGROUND	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
EXPERIENCE	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
AGE	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
INDEPENDENT DIRECTOR MIX	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
ETC.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

COMMENTS, SUGGESTIONS, QUESTIONS

performance. However, if the company is constrained by resources, a simple survey may provide a quick and easy solution. In fact, many companies do choose to conduct a confidential survey.

If the objective of the Board evaluation is to enhance Board performance, it is appropriate to invest in an interview process with an experienced third party – and include management feedback. A unique combination would be a survey supplemented by a focus group discussion.

Innovative Boards use different methodologies to see the Board's performance through different lenses³⁸.

4. **Analysis:** Collate and analyze the results, which must be handled properly. Confidentiality in the method of collection and storage of information is extremely important. All contributions by directors in the final evaluation report and assessment results should be anonymous and non-attributable. This can be quite problematic with small sized Boards since it is often very difficult to disguise the source of sensitive and critical comments. Procedures should include a feedback loop with immediate responses to any concerns. The assessment results should be distributed to directors in time for deliberations during the off-site annual strategy meeting.

5. **Follow Up:** Present results to the Board for discussion, recommendation, and concrete action, including:
 - Action items to remedy any deficiencies;
 - Changes in structures and practices to improve Board and management engagement;
 - Review of the Board evaluation process itself to elicit improvements for the following year;
 - Include action items on Board meeting agendas and the annual off-site strategy meeting with senior managers;
 - Ensure that the annual calendar includes an off-site strategy meeting, annual Board evaluation, and engaging opportunities for continuous learning and development.

Board development is a logical outcome of Board evaluation. Professional director development is now occurring. For example, the Brazilian Institute of Corporate Governance (IBGC) offers professional seminars and regularly organizes study tours for its members to benchmark their performance against international best practice standards.

38 Beverly A Behan (2009) Best Practices in Board Evaluation and Individual Director Evaluation

VIII. LOOKING AHEAD

“What is important for the success of the Board’s performance review is that it is done transparently with the right intention and in the proper manner.”

Worldwide, Board evaluations are moving beyond ‘box-ticking’ and compliance checklists. Instead, senior leaders are tailoring assessment instruments to highlight strengths, identify gaps and produce recommendations that are formally discussed on an annual basis.

At present most of the Board evaluations only require input from the Board members. However, as demonstrated by the Rallis case, the assessment process is an opportunity to strengthen Board and management engagement. This requires trust and candor among Board members and senior managers. Companies that take a more comprehensive view of evaluation seek feedback from:

- **The executive management team**

The Board may wish to widen the assessment to include formal feedback from this essential resource. The Board’s relationship with executive management influences every aspect of the company’s strategy, financial oversight and performance. Senior managers’ understanding, trust and confidence in the Board are essential. Otherwise, managers may not be willing to engage candidly in the Board evaluation process.

- **The shareholders**

The relationship between the Board and shareholders is very important in order for the Board to advance the strategic interests of the company. To enhance confidence in senior leaders’ performance, the Board may wish to include a description of the Board’s evaluation procedures in the annual report, moving toward greater disclosure and transparency the future. This is only recommended when an independent external facilitator assists in the process, and when there is clarity, in advance, about the degree and extent of public reporting.

- **The Regulators**

In highly regulated sectors such as banking and financial services, the regulator’s relationship with the Board is very important and the Board may therefore wish to engage an independent third party evaluator to elicit feedback from this important stakeholder.

- **Other key stakeholders**

The Board may also wish to engage an independent third party evaluator to assess feedback from key stakeholders such as market analysts, the media, customers, NGO’s, employees, and environmental groups. When undertaking an independent evaluation, it is always useful to research what is being said by designated stakeholders as this sheds some light on the questions to raise in the one-on-one interviews.

Over time, Boards can expect increased access to standardized instruments such as web-based evaluations. When, with who and how best to use? Benefits of on-line Board evaluations could include efficiencies in cost, convenience and accessibility. Some claim that long-distance communication is less emotional, and less threatening. It may be easier, for example, for directors to review and manage their responses. A major concern, and priority, is to maintain confidentiality.

In the future, Boards will increasingly be put under pressure from shareholders and other stakeholders to describe the Board evaluation process that has been undertaken in detail. This may involve describing in the Annual Report how an external evaluator was selected and appointed and the processes that were employed (e.g. questionnaires, one-on-one interviews, etc.). Disclosure in the Annual Report of the findings of the Board evaluation (or at least a summary of the findings) and details of the Board development plan may also become

39 Kar and TMTC Team (2009)

more common. It can be argued that publication of this information will signal to key stakeholder groups that the company is taking seriously its governance responsibilities' and the effective performance of its Board.

In the future, as approaches to Board assessment continue to evolve. Important reminders include:

- The Chairperson plays a vital leadership role – orienting senior leaders to the benefits of Board evaluation and ensuring a fair, legitimate process.
- Engage all concerned parties in the discussion of the purpose, objectives, process, and outcomes. Summarize understandings in a written format.
- The Chairperson and the CEO play a key role in developing and approving the process.
- Benchmarks of Board, committee, executive, and company effectiveness are used as performance indicators.
- The Chairperson provides the full Board with a report.
- The assessment process itself should be reviewed for improvements to be undertaken in the following year.
- Reserve time on the Board's calendar for regular annual reviews.

A Board evaluation issue that deserves more focused, country-specific attention relates to the independent director's role. In India and beyond, independent directors are now required to lead the evaluation of their peers. Board members then evaluate the independent director to decide whether he or she will be reappointed to the Board. The risks? Board members may decide not to

reappoint an independent director if they are threatened by the evaluation results. Thus, independent directors may be tempted to take the easy way out, perhaps resorting to 'box ticking' assessments that focus more heavily on compliance. Such findings are important, but they rarely contribute to the Board's development and improved performance.

The challenge remains: how to ensure that independent directors can bring "an objective view" to the evaluation of the Board? Ultimately, independent directors need to trust the Chairperson's intentions, authority and judgment. Negative leadership attitudes, such as indifference and defensiveness, are powerful psychological threats to the Board evaluation process and its potential impact.

In the near future, we recommend that independent directors and other senior leaders in India engage with impartial facilitators for a careful analysis of potential Board evaluation conflicts: personal, structural and business. Pragmatic solutions will clarify governance roles, rules and procedures by taking into account differing Board leadership cultures.

What is valued most is the spirit of inquiry. Advancing the quality and impact of Board evaluation requires a new level of senior leader commitment and engagement. In the future, effective Boards will continuously reassess and improve their performance, including the review of traditional roles and established procedures. The Chairperson plays a vital role in orchestrating this performance improvement process. Simply stated: Board leadership – the tone at the top – will continue to matter.

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