Board Evaluation – Comparative Analysis

2012 Report

CRISCI & PARTNERS
SHAREHOLDERS AND BOARD CONSULTING

Index

About *Crisci & Partners*

Crisci & Partners is an independent professional firm with long and significant experience in the area of consultancy, aimed at the continuous improvement of the structure and practice of corporate governance, of the composition, functioning and self-evaluation of the Board of Directors and its Committees, and the development of corporate leadership.

Thanks to the significant experience acquired by our team, we offer professional research and evaluation services for executive and non-executive directors and for positions at Board level – Chairmen, CEOs and Directors – executives that report directly to the Board – General Managers and Chief Financial Officers – and who liaise with the Board of Directors on specific areas – Board Secretaries, Chief Corporate Governance Officers, General Counsels, Compliance, Audit and Risk Managers. We help in the formation and refining of Boards of Directors, on competences, personality and diversity, boasting unique experience in the search for Chairmen, CEOs and Independent Directors.

Executive Summary

By law and regulation, the role of the director is to represent the best interests of the corporation. A board of directors has no hierarchical structure; it is made up of members possessing diverse high-level knowledge and collegial responsibility.

Board behaviour and effectiveness are becoming increasingly visible to investors, as well as all other stakeholders. Before the profound economic effects of the financial crisis, the evaluation of board performance was rather limited. For many boards it used to be a box-ticking exercise, which showed the low engagement and importance given to the process.

Boards of directors are now facing increased scrutiny and, from the recent market turmoil, it has emerged a clear recognition that regular, more focused and more qualitative review of board composition, performance, behaviour and dynamics is valuable best practice. If appropriate, board evaluation (also called “board assessment”, “board review”) has the potential to significantly enhance board effectiveness, maximise strengths and tackle weaknesses.

Benefits of the process revolve around: providing an opportunity to understand board dynamics and mechanics; increasing awareness of the board members by giving them the opportunity to evaluate themselves; setting the mechanisms for a change towards better boards; reducing personal liability risks or damage to their reputation; improving board overall productivity; enhancing the public perception of the board; defining the board culture.

Several national regulations, whether corporate governance codes, listing requirements or corporate laws, require boards of all listed companies to conduct periodic performance evaluations. Furthermore, some credit agencies consider board reviews as criteria in their rating systems of company governance. In the last two years, the European Commission has reinforced its focus on the corporate governance matters, issuing two Green Papers consultations in this regard.[1] Both raise, among other aspects, the issue of increased board responsibility in the corporate governance framework through better functioning and more appropriate structures. Most EU jurisdictions,

[1] Commission Green Paper on Corporate Governance in Financial Institutions and Remuneration Policies; and Commission Green Paper on the EU Corporate Governance Framework.

including Italy, have reviewed their codes of corporate governance in the recent years, incorporating relevant requirements for increasing board effectiveness.

In the UK, ICSA (Institute of Chartered Secretaries and Administrators) publishes annually a report on board review practices of UK listed companies. In Italy, *Crisci & Partners* has, since 2009, issued two reports analysing the Italian companies' board evaluation practices, specifically for FTSE MIB companies (40) and FTSE Italia STAR companies (73). In both years, the larger group of Italian listed firms proved better compliance in adopting best practices on board evaluation. The analysis also showed a slight improvement in 2010 comparing to 2009 for both groups, notwithstanding the slow progress overall.

This year's report provides a comparative analysis between the largest Italian and UK listed companies.[2] Our data includes 50 largest Italian companies listed on FTSE Italia All-Share (comprising the 40 companies listed on FTSE MIB); and 50 largest UK companies listed on FTSE 100. We therefore looked at the largest Italian and UK companies by market capitalization.

A comparative analysis between the largest Italian and UK firms is relevant for at least the following reasons: i) UK companies are traditionally ahead of other European companies in implementing governance best practices; ii) the UK corporate environment has had a long culture of board evaluation processes, ever since its 2003 Combined Code requirements; iii) only recently have companies across EU jurisdictions started to become more engaged with board evaluation processes and investors more selective and demanding in choosing their participation.

Our investigation, based on the disclosure provided by the companies in annual reports/corporate governance reports, reveals significant differences in scope and methodologies between Italian and UK board assessment processes. A large number of Italian firms provide limited *disclosure* of the board review process, making it difficult to assess both the periodicity of internal/externally-facilitated evaluation and the mechanics of the process. UK firms more clearly report on board review mechanics and adoption throughout the last 3-year cycle, thus providing a better image of its evolution and benefits.

Most Italian firms have not engaged an *external consultant* to conduct their board assessment in the past three years, nor make statements in this regard. In the 2011 reporting year, less than half appointed an external party. Externally-facilitated board review was adopted widely by UK firms within the latest 3-year period, about half of them doing so in 2011. The involvement of the external party in the process may have several levels: offering independent advice to the board throughout the process, or simply acting as impartial facilitators. Based on the disclosure provided by the firms from both jurisdictions, generally it is unclear which of the two approaches has been adopted.

Given the potential conflicts, *independence of the external facilitator* is of utmost importance and disclosure should be made about whether an external evaluator has any other connections with the company. We find that not all firms who make use of an advisor provide explanations regarding its independence; only half of the UK companies and one Italian company specifically state the independent status of the consultant. While still a few companies reveal the identity of the external facilitator, from the available information we conclude that the UK market has a broader and more specialised number of consultancies comparing to Italy.

[2] Crisci & Partners also issued a Peer Analysis Report (2012), providing a comparative analysis of board evaluation practices between some major Italian companies and their European peers.

The *subject of evaluation* varies greatly among firms. Most commonly, as is generally the case in Italy, the evaluation covers the board as a whole and its committees. The majority of UK firms extend the scope of the evaluation to cover the individual board members, the chairman and, in some cases, the executive directors. We contend that evaluation of the individual directors and of the chairman, beyond the assessment of the board in its entirety, may contribute to weighing each director's contribution, effectiveness and commitment to the board.

The *methodologies* used to determine the evaluation output vary. Companies may employ questionnaires, interviews, minutes and documents from board meetings, or a combination of these. We find that the primary tools used in both jurisdictions are the questionnaires, although a tendency towards increasing use of interviews has emerged. In addition, several UK firms use observations from direct participation at board/committee meetings or meeting minutes. While questionnaires address issues related to past performance, interviews allow for more space to approach the future plans and strategy of the board. Interviews also enable open discussions and diversity of interpretations, as opposed to the closed question that questionnaires are based upon.

The general board assessment process examines board processes and structures. However, several UK companies go beyond this approach and additionally identify risk management and control, strategic coordination, observation of behaviours and interactions, engagement with investors and external stakeholders.

Communicating the outcome of the board assessment process is an important means for the follow-up implementation and for enhancing dialogue with the stakeholders on board matters. A large number of companies in both jurisdictions report on the positive feedback from the evaluation, however around half of the UK and less than half of the Italian firms report on areas that require further improvement. We argue that, while communicating positive results may stimulate boards and investors for the benefit of the whole company, acknowledging the areas that need improvement proves a more responsible and proactive approach, looking prospectively and not just retrospectively.

Among the main *areas of excellence of boards functioning as reported by the firms* in each of the two jurisdictions, we identify the following:

Italian firms:

1. Appropriate board membership structure
2. Appropriate board size
3. Effective board operation / decision-making process
4. Board mix of professional skills
5. Good, cohesive climate within the board

UK firms:

1. Effective board operation / decision-making process
2. Committee effectiveness
3. Individual directors' performance/contribution/commitment to the board
4. Degree of interaction between executives and non-executives
5. Chairman leadership/performance/contribution

The following list concerns primary *areas for further improvement as reported by the firms* in each jurisdiction:

Italian firms:

1. Understanding issues concerning risks and corporate strategies
2. Deeper analysis of regulatory environment
3. Simplification of documentation addressed to directors
4. Strengthening of knowledge on technical and operational issues
5. Increase the number of independent directors

UK:

1. Understanding issues concerning risks and corporate strategies
2. Review of succession plans
3. Increased interaction between executives/management and non-executives
4. Better allocation of time for board meetings
5. Simplification of the reporting systems and documentation

The overall results of our comparative analysis seem to reflect, to great extent, the regulatory requirements in the two jurisdictions, which are similar at the level of general principles whilst varying in substance. UK requirements are notably stricter and more focused on the scope and disclosure of the process, while the recent Italian requirements remain at a more generic level. The fact that UK companies started to provide board reviews much earlier than Italian ones also explains the progress made by the former group of companies comparing to the latter group.

Perhaps more remarkable are the variations as to the scope and methods adopted by the companies within each jurisdiction. In our view, each board of directors should independently consider the optimal board and committee structure and how to implement its performance assessment. What is optimal will depend on the company's circumstances at a given time and will be impacted by matters such as the business and regulatory environment, the costs, benefits and challenges involved.

It is our consideration that regular (yearly), well-conducted evaluation helps the board and its committees perform to their maximum capabilities. Boards embrace a certain culture whose tone is set by the chairman; therefore assessment of chairman's attitude and contribution is of vital importance to the board's overall setting and strategy. Evaluation of the individual directors' performance is also important in order to gauge their impact on the overall board function.

Internal self-evaluations should be supplemented with periodic externally facilitated evaluations. Regular use of an external facilitator could improve board performance assessments by bringing an objective perspective and sharing best practices from other companies. One of the problems is that there still seems to be only a limited number of board review service providers. As with all market issues, greater demand, however, is likely to engender a better offer. Specialisation and independence of the external evaluator are key.

Board evaluation should not be a function of compliance with the rules, but rather a process enabling the board to acknowledge and reflect on the current and future governance needs of the company, by providing a platform for discussion and strategic changes. It should therefore result in developing a plan for the board and its individual members.

We strongly support the view that the more thorough the evaluation is done, the more benefits it brings to the board and the company at large. Once companies have been through a proper evaluation and have acknowledged the benefits it brings, they are more willing to repeat the event. Boards will effectively address any weaknesses only when they acknowledge what these are.

Next we provide a description of the regulatory framework relative to board evaluation in Europe. This is followed by a comparative analysis between UK and Italian board evaluation practices. The Appendix provides extracts on board evaluation practices reported by the companies included in our analysis.

Regulatory framework

Recent corporate scandals have resulted in a wave of demands for corporate governance reforms, including the calls for boards of directors to evaluate their own performance in an effort to strengthen and improve overall corporate management. In a few countries boards are now legally required to conduct performance evaluations in order to meet applicable corporate governance standards. For example, companies with securities listed on the US New York Stock Exchange (NYSE) are required to comply with such requirement according to Section 303A of the NYSE Listed Company Manual. In Europe, most corporate governance codes require companies to conduct regular performance assessments of their boards of directors.

Already in 2003, the UK Combined Code of Corporate Governance (upon Sir Derek Higgs' suggestion) recommended boards "to undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.[3]

The latest version of the UK Code issued in June 2010 by the Financial Reporting Council (FRC), incorporated a recommendation that FTSE 350 companies undertake an externally facilitated board evaluation at least every third year.[4] This change to the Code has catalysed an increased interest in board evaluations in a wide range of organisations, beyond those of the FTSE 350. Furthermore, in March 2011 the FRC also published its 'Guidance on Board Effectiveness', to encourage the boards of listed companies to consider how they can lead their companies most effectively.[5] Meantime, the 2009 Walker Review of corporate governance reached the conclusion that not all boards had given board evaluations the deserved attention and thoroughness. The document calls for greater use of externally facilitated, rather than internal, board evaluation.[6]

The 2006 Italian Corporate Governance Code recommended that listed companies annually conduct a performance self-evaluation of board and committee size, composition and performance. Recently, new best practice regulations have been adopted in Italy. On December 5, 2011, the Committee for Corporate Governance published a revised Code of Corporate Governance for listed companies.[7] The changes introduced in the Code reflect the numerous reforms that have been adopted in the regulatory landscape in the last five years relating to corporate governance. These have a clear focus on boards, affecting four areas in particular: (i) the composition of the board of directors; (ii) the role and function of the board of directors; (iii) the organisation and composition of board committees; and (iv) internal systems of control and risk management.

[3] Financial Reporting Council, "The Combined Code on Corporate Governance", July 2003, Principle A6.
[4] Financial Reporting Council, "UK Corporate Governance Code", December 2010.
[5] Financial Reporting Council "Guidance on Board Effectiveness", 2011.
[6] David Walker, "A Review of Corporate Governance in the UK Banks and Other Financial Industry Entities", November 2009.
[7] Corporate Governance Committee, Corporate Governance Code, December 2011.

The Italian Code revises and strengthens the recommendation regarding board evaluation, which should include an examination of their respective size and composition with respect to their ability to carry out their functions. In particular, it recommends that the board of directors consider whether it has an adequate representation of the various board of directors' constituencies (executive, non-executive, independent) and of the different professional and managerial competences, including experience in international markets.

In January, the Bank of Italy, in its quality of national banking supervisor, issued guidelines on internal governance asking banks to conduct periodic self-evaluations of their boards. By March 2012, banks had to submit to the Bank of Italy a report describing the methodologies used and the actions implementing the outcome of their evaluations.

Most other European codes of corporate governance incorporate some provisions regarding the board assessment process, however the approach varies: some codes are rather vague about it (e.g. Germany), while others place stronger emphasis on the importance of the process (e.g. France). Some codes are silent on how to carry out an efficiency check in practice, while the importance of conducting performance assessment with the assistance of an external expert is raised differently in each jurisdiction.

As a result of the reforms in regulation, more EU boards are now conducting performance assessments in order to meet legal, investor and community expectations. Nonetheless, board evaluation should not be a function of compliance with the rules, but rather a process enabling the board to acknowledge and reflect on the current and future needs of the company, by providing a platform for discussion and strategic changes.

Consequently the methodologies adopted in practice vary, being influenced by, inter alia, changes and dynamics in the company lifecycle, the annual cycle of the board and committees, corporate strategy, corporate structure, culture and external frameworks.

Analysis of company practices

The investigation is based on a set of criteria covering the following aspects:

- Board evaluation conducted in 2011
- Party conducting the evaluation
- External evaluation in the last 3 year-cycle
- Methods of board evaluation
- Subjects being covered by evaluation
- Aspects covered by board evaluation
- Communication of evaluation outcome
- Disclosure of external facilitator

Company data is represented by the largest 50 Italian and 50 UK listed companies by market capitalization (as at 2011).

Italian companies

1. ENI
2. ENEL
3. GENERALI
4. INTESA SANPAOLO
5. TENARIS S.A.
6. SAIPEM
7. UNICREDIT
8. SNAM RETE GAS
9. TELECOM ITALIA
10. LUXOTTICA GROUP
11. ENEL GREEN POWER
12. ATLANTIA
13. FIAT INDUSTRIAL
14. TERNA
15. EDISON
16. STMICROELEC.N.V
17. MEDIOBANCA
18. FIAT
19. PIRELLI
20. CAMPARI
21. UBI BANCA
22. BANCA MONTE PASCHI SIENA
23. BANCA CARIGE
24. MEDIASET
25. EXOR - ORDINARY
26. PARMALAT
27. A2A
28. MEDIOLANUM
29. PRYSMIAN
30. LOTTOMATICA
31. TOD'S
32. AUTOGRILL
33. BANCA POPOLARE SONDRIO
34. BANCO POPOLARE
35. SALVATORE FERRAGAMO ITALIA SPA
36. FINMECCANICA
37. BANCA POPOLARE EMILIA ROMAGNA
38. SIAS
39. ERG
40. HERA
41. RECORDATI
42. BUZZI UNICEM
43. DIASORIN
44. ACEA
45. ANSALDO STS
46. DE’LONGHI
47. IMPREGILO
48. BANCA POPOLARE MILANO
49. CIR GROUP
50. CREDITO EMILIANO

Source : FTSE

UK companies

1.HSBC HLDGS
2.VODAFONE GROUP
3.BP
4.ROYAL DUTCH SHELL
5.GLAXOSMITHKLINE
6.BRITISH AMERICAN TOBACCO
7.RIO TINTO
8.BG GROUP
9.BHP BILLITON
10.DIAGEO
11.ASTRAZENECA
12.STANDARD CHARTERED
13.SABMILLER
14.ANGLO AMERICAN
15.UNILEVER
16.RECKITT BENCKISER GROUP
17.TESCO
18.BARCLAYS
19.XSTRATA
20.IMPERIAL TOBACCO GROUP
21.NATIONAL GRID
22.PRUDENTIAL
23.CENTRICA
24.BT GROUP
25.ROLLS-ROYCE HOLDINGS
26.TULLOW OIL
27. SCOTISH SOUTHERN ENERGY
28.LLOYDS BANKING GROUP
29.COMPASS GROUP
30.SHIRE
31.WPP
32.EXPERIAN
33.BAE SYSTEMS
34.PEARSON
35.AVIVA
36.CRH
37.BRITISH SKY BROADCASTING GROUP
38.MORRISON (WM) SUPERMARKETS
39.ARM HOLDINGS
40.OLD MUTUAL
41.KINGFISHER
42.LEGAL & GENERAL GROUP
43.WOLSELEY
44.REED ELSEVIER
45.INTERNATIONAL POWER
46.BURBERRY GROUP
47.AGGREKO
48.SAINSBURY
49.GLENCORE INTERNATIONAL
50.MARKS & SPENCER GROUP

Source: FTSE

Disclosure

Disclosure is a sensitive issue of board evaluation. Some boards may be reluctant to issue detailed findings of the process. On the other hand, external stakeholders, particularly investors, are keen to ensure that the board review process provides more than corporate 'window dressing'. Companies should therefore find the right balance in reporting the process, thus providing a starting point for shareholder-board engagement on the board performance.

Our analysis is confined to what companies present in their 2011 annual reports/corporate governance reports relative to the board evaluation process. Due to the limited disclosure adopted by several companies, it is difficult to assess the exact number of companies who are conducting internal and external board reviews each year, the methodology and outcome. It is our belief that, in order to provide a full picture of the process, companies should explain the board's cycle of internal and external reviews and the year of the last external review (or explain the reasons why this was not conducted).

Although not always complete, UK firms' disclosure is generally at higher levels comparing to that of Italian firms, being more informative and better reflecting the characteristics of the process. Some UK companies do have low disclosure, however the number of Italian companies with such approach is greater. Whilst similar guidance relating to disclosure is provided in both the UK and Italian Corporate Governance Codes, the more comprehensive requirements of the Walker Report, addressed primarily to banks, may have stimulated other UK companies in reporting the process in more detail.

2011 Board evaluation

Board evaluation has become a regular, disciplined activity for a large number of companies, however disclosure in the annual corporate governance or annual financial statements does not always provide a clear picture as to the periodicity of this practice, in particular as to whether an evaluation has been conducted in the last three-year lifecycle. Particularly in the case of Italy, it is possible that some firms have performed external board evaluation, however not communicating this in their annual / corporate governance report.

From the descriptions provided by the UK companies, it emerges that all have conducted annual evaluation in the past 3 years. Some UK firms clearly draw out the 3-year cycle evaluation process in diagrams, which helps the reader understand the benefits of such process (see e.g. Vodafone, National Grid, in Appendix).

Out of the 50-50 sample, 46 Italian (92%) and all 50 UK companies conducted a board review in 2011. Among the rest of the Italian firms, 2 state that they have not performed any evaluation (Campari arguing against the need for an evaluation; Mediobanca starting the process for the first time next year)[8] and for 2 (4%) companies we did not find any related documentation.

The two above-mentioned Italian firms provide some explanation for not engaging in an evaluation process.

[8] It is understood that no evaluation had been conducted at all by these two companies in the last 3-year cycle.

"The Board did not assess the size, composition and operation of the Board itself and of its committees, and did not issued guidelines on what professional profiles would be expedient in its members, preferring to leave this assessment to the shareholders at the time of the Board's renewal. The Board does not find such assessments particularly useful in terms of concrete application. It is in fact unlikely that the very parties performing the assessment would come up with a negative opinion as to the functioning of the Board or recommend addition of new professional profiles, as this would imply that the directors in office do not have all the qualifications required for the position. Similarly, the Board does not wish to appoint a consultant to perform such an assessment, as this would not meet the need for an independent third-party opinion but would result in a significant cost for the company." (Campari)

"In view of the imminent publication of new regulations on this issue by Consob, the Board of Directors' self-assessment will commence as from the next financial year." (Mediobanca)

2011 Evaluation	**Italy**		**UK**	
	No of firms	%	No of firms	%
Has conducted an evaluation	46	92%	50	100%
Has not conducted an evaluation	2	4%	0	0%
No documentation	2	4%	0%	0%

External facilitation

Common best practice suggests that an external review of the board should take place at least every three years, alternating with internal evaluations in the intermediate two-year period.

Most Italian companies have not engaged an external consultant to conduct their board evaluation in the past three years, nor make any statement as to any past or future engagement of such party. 15 Italian companies (31%) state that they had appointed an external advisor in the most recent 3-year cycle, while 33 (65%) do not make any reference to such approach. In 2011, 14 companies (30% of the companies undertaking an evaluation) conducted the process using an external advisor.

Externally-facilitated board evaluation has been adopted widely by the UK firms, 44 (88%) of them stating that they had engaged an external advisor within at least the recent 3-year cycle. In the year in review, 26 (52%) companies conducted their board review soliciting an external party. Some UK companies (6 companies according to what is disclosed) have appointed an external advisor even more often, i.e. in two/three consecutive years.

The involvement of the external party in the process can have several levels: they might offer independent advice to the board throughout the process, or simply act as impartial facilitators. Generally, the disclosure provided by the companies does not clearly reveal which of these stances has been adopted.

Given the potential conflicts, the external facilitator should not have an ongoing relationship with the company, i.e. not engaging in other consulting services for the company or management (human resources, executive search, operational advisory, legal or auditing services etc.). According to a provision in the UK Corporate Governance Code, a public disclosure should be made about whether an external evaluator has any other connection with the company.

Nevertheless, not all firms who make use of an advisor provide explanations regarding its independence. In Italy one company specifically states the independent status of the consultant, while in the UK 15 companies (58%) do so. Out of the companies that undertook an external evaluation of their board in 2011, 9 (64%) in Italy and 24 (92%) in the UK disclose the name of the external party.

Companies choosing to bypass a formal annual evaluation are probably unwilling to expose themselves to a proper evaluation, and/or do not acknowledge the need for such process. One of the examples in this respect is Intesa Sanpaolo, who "*chooses not to use any external consultants, in the belief that the process could be effectively conducted through appropriate and constructive discussion within the Board and among the Board Members*".

Externally-facilitated assessment may raise some concerns. Currently, there are only a limited number of external consultants with direct experience of the implementation of board evaluation reviews. Considering the companies that disclose the name of the external advisors, we identify 4 names of consultants in Italy and 13 consultants in the UK. This also shows that the UK market is more mature and regards board evaluation with increased focus.

Aside from the need for compliance with standard regulation, a firm's approach should be subject to its board's strategy, past or upcoming circumstances and the objectives of the assessment process. In-house processes may have some advantages, e.g. causing less concerns to boards that are reluctant to conduct a board evaluation. However, adopting only an internal mechanism throughout a board lifecycle may refrain the board members from revealing some aspects that could be problematic, thus eroding the real picture. The benefits of external evaluation are obvious, i.e. creating an objective, more focused process and adding value to it. Alternating between internal and external processes during a 3-year cycle provides a more complete board evaluation.

External evaluation in the last 3-year cycle	**Italy**		**UK**	
	No of firms	%	No of firms	%
Yes, it has engaged an external facilitator	15	31%	44	88%
No, has not engaged an external facilitator	2	4%	1	2%
No disclosure	33	65%	5	10%

Parties conducting internal board evaluation

Companies conducting the process internally may appoint various parties to conduct the evaluation: the chairman (a practice adopted only by UK companies), the lead independent director, a special committee (usually Nomination / Corporate Governance Committee), committee chairmen, the corporate board secretaries or the corporate affairs/legal function. On several occasions, the leadership of the project is supported by a second party, e.g. the chairman leading the process while the corporate secretary (in the UK) or the Nomination / Governance Committee (in Italy) conducts the actual operational tasks. The following table presents the parties responsible for leading the evaluation process in 2011.

Party conducting the evaluation	Italy		UK	
	No of firms	%	No of firms	%
External advisor	*14*	*30%*	*26*	*52%*
Chairman	1	2%	12	24%
Lead Independent Director	4	9%	3	6%
Committee (Nomination / Corporate Governance / Other)	13	28%	5	10%
Company secretary / Corporate Affairs	4	9%	4	8%
No disclosure	13	28%	5	10%

Note: Total is above 100% as more options can be applied by one company.

Subjects covered by the evaluation

Commonly, the process regards evaluation of the whole board and of the board committees. This is the case for most Italian companies, following the approach in line with the national Code requirements. According to what is reported, 3 (7%) Italian companies appear to include in their methodology also the assessment of individual directors,[9] while 3 firms (7%) do not provide any details of the scope of evaluation.

In addition to evaluating the board as a whole and its committees, the majority of UK companies (74%) conduct assessment of the individual directors. A significant number of UK companies (72%) also evaluate the role and effectiveness of the chairman. Assessing directors and the chairman individually is according to best practice recommendations of the UK Code. Some companies (24%) also conduct assessment of their main executive corporate officers.

Evaluation of the individual directors goes beyond the assessment of the board in its entirety, aiming to weigh whether each director continues to contribute effectively and demonstrates commitment to the role (including commitment of time for meetings of the board and committees, and any other duties). The chairman could accordingly act on the results of the performance evaluation and, in consultation with the nomination committee, propose new board members to be appointed where and when appropriate.

In cases where the chairman and executives are included in the scope of the assessment process, the internal procedure is as follows: the chairman leads the assessment of the chief executive and the non-executive directors; the chief executive undertakes the performance reviews for the executive directors; and the senior independent director leads the review of the performance of the chairman. However, this is not standard procedure, as each company is a unique case and adopts its own processes.[10]

[9] This is not clearly described in their reports.
[10] For example, SAB Miller hands the performance of its chief executive to the remuneration committee, which is afterwards shared with and considered by the board.

Subjects of the evaluation	Italy		UK	
	No of firms	%	No of firms	%
Board	46	100%	50	100%
Committees	44	96%	48	96%
Individual directors	3	7%	37	74%
Chairman	0	0%	30	72%
Executives	1	2%	12	24%
No disclosure	2	4%	0	0%

Note: Total is above 100% as more options can be applied by one company.

What does board evaluation cover

According to the disclosure provided, Italian companies generally undergo a basic performance evaluation process covering the structure and functioning of the board and its committees, in order to determine their effectiveness and membership adequacy. The process generally investigates the climate within the board, the structure and number of meetings and, at most, the decisional process within the context of the meetings.

Several UK companies go beyond this approach and additionally identify: experiential and technical gaps in boards' functioning, risk management and control, strategic coordination, observation of behaviours and interactions, engagement with investors and external stakeholders. These companies take a forward-looking approach, rather than simply a follow-up approach. This is a positive aspect considering that, lately, there has been an increased awareness in the need to focus on the board dynamics rather than just the mechanics of their behaviour. Whilst the composition and functioning of the board may even be considered outstanding, the board should plan for the next few years to build on its relevant skills and competencies; therefore assessing its approach to risk, strategy and its dynamics is important.

An aspect emerging in the most recent evaluation at some Italian companies is the remuneration of board members, in consideration of the new recommendations issued by the Italian Stock Exchange under the influence of a number of initiatives within the EU, that led to a revised Section 7 of the Italian Code of Corporate Governance (see Lottomatica, Prysmian).

Evaluation areas	Italy		UK	
	No of firms	%	No of firms	%
Board structure and functioning	44	96%	49	98%
Strategy, risk processes, technical gaps, dynamics	3	7%	22	44%
No disclosure	2	4%	1	2%

Note: Total is above 100% as more options can be applied by one company.

Methods of board evaluation

The process used to determine the types of output from an evaluation varies across firms. Companies employ questionnaires, interviews, minutes and documents from board meetings, or a combination of these. While questionnaires address questions related to past performance, interviews allow for more space to approach the future plans and strategy of the board. Another difference between the two methods is the freedom to open discussions and diversity of interpretations in the case of interviews, as opposed to the closed question that questionnaires are mainly based upon. We note that, where evaluation is conducted with the assistance of an external advisor, there is a higher use of both questionnaires and interviews. Some UK consultants also choose to sit in meetings of the board and use minutes to complete the assessment.

While there is no perfect method and each firm should adjust methods and questions to its own objectives, a rigorous assessment based on interviews and observations during board meetings provides a complete approach, enabling the identification of specific areas where improvement is needed, while still in early stages.

From the disclosed information, it emerges that most boards use questionnaires (61% in Italy and 62% in UK). Individual interviews of directors occur in 22% of Italian companies and 54% of UK evaluations. The use of observations from direct participation at board/committee meetings or meeting minutes occur at 5 (11%) Italian and 5 UK (10%) firms. However, 17 (33%) companies in Italy and 9 companies (18%) in the UK do not provide any information on how their evaluations are executed.

Methods for evaluation	**Italy**		**UK**	
	No of firms	%	No of firms	%
Questionnaires	28	61%	31	62%
Interviews	10	22%	27	54%
Questionnaires + Interviews	7	15%	14	28%
Meeting documents	5	11%	5	10%
No disclosure	17	33%	9	18%

Note: Total is above 100% as more options can be applied by one company.

Communication

Depending on the approach taken, the findings and recommendations from an evaluation can be communicated in a number of ways, such as using written documents, board presentations, individual meetings between board members and the chairman, and collective discussions. Sharing the results of the assessment among the board members and discussing the impact and deciding on the techniques to address the issues emerged from the assessment is of vital importance to any firm.

From the Italian companies undergoing evaluation last year, most (85%) report a positive outcome, however only 35% acknowledge also the improvements that need to be addressed in the future. A large number of UK companies report on the assessment results, specifically on the positive feedback from the evaluation (76%) as well as areas of improvement for the board (54%).

While communicating positive results may stimulate boards and investors in the benefit of the whole company, acknowledging the areas that need improvement proves that boards have a responsible and proactive approach, looking prospectively and not just retrospectively.

A compelling approach taken by several UK firms is the review of decisions made in the previous year and mapping out the actions to implement those decisions, then stepping back to assess to what extent the important decisions were tackled in the proper order of priority. This is important, as one of the advantages of undertaking an annual evaluation is, in fact, the possibility to monitor trends in responses to questions and track progress made against action plans (see for example GSK, Anglo American and Barclays).

Communication of evaluation outcome	Italy		UK	
	No of firms	%	No of firms	%
Communicating areas of excellence	39	85%	38	76%
Communicating areas of improvement	16	35%	27	54%

Note: Total is above 100% as more options can be applied by one company.

Outcome of board evaluations

We further identify and summarise the most frequent observations made by companies reporting on their areas for excellence and areas for improvement, respectively. The aspects are listed according to the frequency reported by the companies.

Italian companies providing disclosure on the results of the evaluation process focus on the areas of excellence rather than on the aspects that need to be improved. Several UK companies have the opposite approach, placing increased focus on the areas calling for improvement.

Areas of excellence – Italian companies
1. Appropriate board membership structure
2. Appropriate board size
3. Effective board operation / decision-making process
4. Board mix of professional skills
5. Good, cohesive climate within the board
6. Effective meeting agendas
7. Quality and timing of information provided to directors ahead of meetings
8. Degree of interaction between executives and non-executives
9. Committee effectiveness
10. Committee adequate composition

Areas of excellence – UK companies
1. Effective board operation / decision-making process
2. Committees effectiveness
3. Individual directors' performance/contribution/commitment to the board
4. Degree of interaction between executives and non-executives
5. Chairman leadership/performance/contribution
6. Focused strategic, risk approach
7. Appropriate mix of professional skills
8. Good, cohesive climate within the board
9. Effective meeting agendas
10. Appropriate induction programmes

Areas of improvement – Italian companies	
1. Understanding issues concerning risks and corporate strategies 2. Deeper analysis of regulatory environment 3. Simplification of documentation addressed to directors 4. Strengthening of knowledge on technical and operational issues 5. Increase the number of independent directors	

Areas of improvement – UK companies
1. Understanding issues concerning risks and corporate strategies
2. Review of succession plans
3. Increased interaction between executives/management and non-executives
4. Better allocation of time for board meetings
5. Simplification of the reporting systems and documentation
6. More development and education (some suggestions for use of external presenters)
7. Strengthen knowledge about the industry competition
8. Off-site meetings
9. Timely delivery of documents to the board / information flow
10. Site visits and specific training

Appendix

(Company extracts)

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