When the chairman underperforms

Chairman ineffectiveness can be the "elephant in the room" for some boards. **Tony Featherstone** investigates what boards can do about it.

KEY POINTS

- Chairman underperformance is not widespread
- A chairman's departure can be very destabilising
- Boards tend to be reluctant to question the chairman's performance
- Few boards conduct a comprehensive assessment of the chairman's effectiveness

One in five CEOs of top 200 Australian listed companies quit during the 2008 global financial crisis, with at least 20 forced out, the latest Booz & Co CEO succession study shows. That so many CEOs fell on their sword at a time of incredible wealth destruction and strategic error does not surprise. More unusual is that so few chairmen resigned during or after the crisis.

Only a handful of chairmen of top 200 listed companies have had to resign in the past two years, a figure that suggests the issue of chair underperformance is a low priority for most boards and major shareholders. But consider what happens when a chairman leaves under acrimonious circumstances: a torrent of bad publicity, share price volatility and board and executive instability. It is among the worst things that can happen to an enterprise, be it public, private, government or not-for-profit (NFP).

"It is wrong to suggest chairman underperformance is widespread," says Nicholas Barnett MAICD, a Mission Australia director, chairman of wealth management firm First Samuel and executive chairman of Insync Surveys, a benchmarking consultancy that has published a survey on chairman performance in Australia and New Zealand. "But when something goes wrong and the chairman is forced to leave, it can be very disruptive for that board. It can also adversely affect the organisation if not handled discreetly. Such departures can take boards and organisations a long time to recover from while trust and cohesion are rebuilt."

Look at Telstra Corporation and Fairfax, two blue-chip organisations that saw their former chairmen, Donald McGauchie and Ron Walker respectively, leave under difficult circumstances. Board renewal may have been exactly what each company needed, but their chairmen's departure, at least in the short term, added to market uncertainty and bad publicity. Forced chairman transitions can destabilise the board, unsettle the CEO and damage other corporate relationships.

The low number of forced chairman resignations relative to CEO resignations suggests three things. First, that chairmen of Australia's largest listed companies are doing a good job. Second, that transition data is flawed because most chairmen are given an opportunity to resign gracefully - behind closed doors - before being asked to leave. Third, that many underperforming chairmen are still running large companies but their boards do not have processes - or the will - to force them to leave. The issue is less clear among private companies and NFP enterprises due to lack of data.

Recent evidence suggests the first explanation - that chairmen are doing a good job - is the most plausible, although there is truth in the other explanations. Eighty per cent of directors of for-profit companies surveyed by Insync said their board's chairman had an effective personal leadership style. And, 72 per cent said their chairman conducted an effective decision-making process. Almost 80 per cent said the chairman had a constructive working relationship with the CEO. Insync's 2010 report, *Chair Leadership - an inside look at how well board chairs perform*, surveyed 778 directors across 92 boards of Australian and New Zealand enterprises.

Photo: Getty Images

TIPS ON DEALING WITH CHAIRMAN PERFORMANCE ISSUES

1. Have a process to manage chairman underperformance. Hopefully the board will not need it, but such a process is vital should the issue arise. Act quickly if it does.
2. Have a clear succession plan for the chairman and understand his or her intentions regarding board tenure. If there are no internal successors, ensure the board has a process to identify an external chairman.
3. Be clear about who would manage the process to recruit an external chairman – the deputy chairman (assuming he or she doesn't want the top job) or the nominations or governance committee?
4. Ensure the board has an annual or biannual performance evaluation.
5. Ensure the chairman does not oversee the review and manage the flow of information when it comes to his or her performance. Find an independent facilitator from the board or elsewhere.
6. Clearly document the chairman's roles and responsibilities so there is a frame of reference against which to manage disputes.
7. Consider publishing a skills matrix in annual reports to ensure more transparency in the mix of board skills and any skills gaps.
8. Consider formal surveys of key stakeholders, such as institutional shareholders, to gauge how they view chairman performance. Ensure independent reporting of such information to the board.
9. Ensure the performance process is so robust that it – rather than directors – forces the chairman to resign. A good process ensures the chairman "sees the issue coming".
10. Act ethically – do not go behind the chairman's back, leak information to the media or canvass support from major shareholders or executives. Keep board issues within the boardroom.

'The increasing use of board reviews and greater focus on measuring board performance has led to smoother chairman transitions in recent years'

DAVID GONSKI

Prominent business leaders, such as David Gonski AC FAICD*Life*, chairman of the Australian Securities Exchange, Coca-Cola Amatil and Investec Bank, believe boards are handling the issue of chairman transition more effectively these days. "Boards are generally better at planning the succession of their chairman than companies are at planning CEO succession," says Gonski. "Every board is different, but I do believe the increasing use of board reviews and greater focus on measuring board performance has led to smoother chairman transitions in recent years. There is a tendency for people in all walks of life to stay longer in a position than they should, but the issue is mostly being handled well."

AGL Energy chairman Mark Johnson FAICD told the annual Australian Institute of Company Directors' conference in New Zealand in May: "In the case of a really bad chairman, you have to fire him or her. And, if that is the collective word of the board, then that is what happens. That, I guess, is very rare... This is where board reviews become particularly important and where the ability to have a frank discussion among all the board members without management being there is absolutely critical. Then you can say: 'Mr Chair or Miss Chair you went too far on that. We are all a bit concerned'."

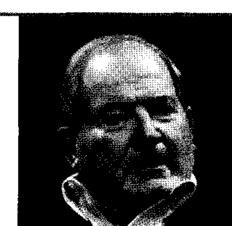
The chairman knows directors are concerned about his or her performance, has an opportunity to improve and can resign gracefully before bigger problems emerge, with his or her reputation intact. There will be no surprises when directors ask a chairman to resign from the board or return to being a director, although the chairman may dispute his or her performance assessment, dig in and return fire at directors.

The idea of board "process" for chairman resignations sounds good in theory but it is not backed up by data. Remarkably, only 10 per cent of directors of NFP boards surveyed by Insync said their board conducted a comprehensive assessment of the chairman's effectiveness. About 20 per cent of for-profit directors thought the same. The figures were even lower when it came to conducting a comprehensive assessment of the performance of board committee chairmen, even though those running audit and remuneration committees, in particular, had more responsibility these days.

Only 42 per cent of directors of for-profit companies, and 35 per cent in NFP enterprises, believed their board had appropriate documentation of the chairman's role and responsibilities. This suggests many boards do not have a rigorous frame of reference against

'This is where board reviews become particularly important and where the ability to have a frank discussion among all the board members without management being there is absolutely critical'

MARK JOHNSON



which their chairman's performance is assessed. Directors may say they are happy with their chairman's performance, but the question is: What is it being assessed against and is the positive view too anecdotal?

In listed companies, shareholders appoint directors and directors elect the chairman. Directors have the power to remove a chairman but cannot force him or her from the board. Only shareholders can elect or remove directors. This makes a forced chairman resignation a messy event requiring great board process to deal with the situation.

The word "process" was used during several interviews for this feature, the idea being that robust board processes identify and communicate chairman underperformance early.

Chairman performance is the "elephant in the room" for some boards, says Lynn Ralph FAICD, joint managing director of board consultancy CameronRalph and a Sydney Swans director. "The notion of questioning the chairman's performance is almost unmentionable on some boards," says Ralph.

"Often, the chairman is much respected, has done a good job in the past and has seen the organisation through various up and downs. The chairman may simply be slowing down if he or she has been there a long time or has been overtaken by the organisation's growth and complexity. The chairman may have appointed and mentored several directors, so in most cases, directors wait for the chairman to retire rather than force the issue, even though this may not be in the organisation's best interests."

Ralph says reluctance to question a chairman's performance leads to poor succession planning, which in turn sees boards persist too long with underperforming chairmen. "The chairman has a special role that requires a mix of skills that can be hard to find. Boards often (erroneously) assume that a currently serving director can step up to the chairman's role, not considering whether that person wants his or her workload doubled and all the extra responsibility that comes with the position. The lack of an agreed to succession plan can see boards stick with a chairman even though his or her performance has waned for some time."

Sidestepping the issue of current or potential chairman underperformance may be why some boards lack a rigorous process to monitor and address the issue. The main technique to measure performance is an annual or biannual board evaluation, but this process can be problematic when it comes to the chairman, says Colin Carter FAICD, a director of Wesfarmers, World Vision Australia, Geelong Football Club and a board adviser with Colin Carter & Associates.

"The chairman usually conducts the board review, oversees the process and controls the communication of results," says Carter. "But this can affect the review's independence in respect of the chairman's own performance - and a board review is very much about the effectiveness of the chairman. It is very important the chairman does not control the board evaluation process. He or she doesn't necessarily need to bring in a consultant; the chairman could let another director oversee the process and communicate the chairman's own performance."

Carter says measuring chairman performance is a not a strong point of most boards. "Boards must have a mechanism that can kick in very quickly if there are concerns about the chairman's performance. It is important that the process is clearly established when the board doesn't feel there is a problem. If boards have not thought about how they would handle the issue of chairman underperformance, in identifying it and addressing it, they will struggle to deal with it properly when they do have a problem."

Arguably, the benchmark for chairman performance needs to extend well beyond a clear succession plan, board review and the usual process of "fire-side chats", where a chairman informally talks to directors about their performance and vice versa. Publishing a clear skills matrix annually for all directors, a practice more advanced in countries such as Canada, would provide a reference point to gauge the chairman's skills set against the board's changing requirements, especially if the company changes strategy, expands overseas or through acquisition. The chairman may no longer have the mix of skills the company requires.

It is also likely more Australian boards will follow, to some degree, performance practices

KEY FINDINGS FROM INSYNC SURVEY'S 2010 REPORT ON CHAIRMAN LEADERSHIP

- Disappointingly, only just over a third of all directors (39 per cent) believe their board has appropriate documentation on the chairman's role and responsibilities.
- Most chairmen (79 per cent) have a constructive working relationship with the CEO but only 43 per cent of directors say the performance appraisal of their CEO is handled well.
- Operationally, chairmen are getting it right; most directors believe their chairman has an effective personal leadership style (78 per cent), decision-making process (72 per cent) and manages the board's workload (64 per cent).
- Measuring chairman and committee chair effectiveness isn't up to scratch, with only 16 per cent and 10 per cent of directors respectively agreeing their performance assessments are comprehensive.
- Directors younger than 45 are consistently more critical of chairman leadership processes than those over 64.

Source: Taken from Chair Leadership – an inside look at how well board chairs perform, Insync Surveys, 2010.

'The lack of an agreed to succession plan can see boards stick with a chairman even though his or her performance has waned for some time' LYNN RALPH

common in management ranks in coming years. This may include a clear job description for the chairman and other directors and even a comprehensive annual performance review.

Insync's Barnett says board reviews are important, but usually assess overall board performance rather than highlight individual director accomplishments or shortcomings. "Our research shows that very few boards conduct a comprehensive review of the performance of the chairman or of individual directors," says Barnett. "Such reviews can be best achieved by 360 degree assessments of directors and the chairman but these are rarely externally administered using a reliable instrument. Reviews administered internally lack rigour as respondents are likely to be less than candid when their anonymity cannot be assured.

"We are probably five years away from seeing more companies publish skill matrices in annual reports, developing individual internal chairman and director job descriptions and conducting regular robust performance reviews," says Barnett. "But it is coming. Companies have recognised the importance of robust measurement of executives and other stakeholders, yet have only just begun to extend this to directors at an individual level. Such a system, if implemented and executed well, provides a transparent, useful assessment of chairman and director performance that is kept within the boardroom. The regular process acts as a trigger for a director or the chairman to leave voluntarily if it becomes obvious his or her performance is not up to scratch.

"Most directors who have been through a process of replacing a poor-performing chairman, director or CEO say they waited far too long to deal with the matter. A regular review process ensures poor performance is identified early as opposed to being allowed to drift. It can be dealt with by remedial action or, when necessary, a replacement."

Many boards also need a more formal process of measuring how stakeholders, especially key investors and their proxy advisers, view the chairman's performance. Chairman of listed companies are spending more time meeting institutional investors and some regularly ask for feedback on the board's performance. But how chairmen report these comments to the board is unclear. Again, there are perceived independence issues if the chairman oversees the reportage of investor comments.

Removing a chairman, especially if he or she is well liked, is never easy. But boards have a duty to ensure all members, including the chairman, perform appropriately. There can be no greater danger to a company than a chairman who takes his or her eye off the ball and allows his or her underperformance to infiltrate director and executive ranks. It should never be forgotten that the chairman's role is special – so special that it deserves its own process to deal with underperformance. One that is fair, transparent and allows the chairman to resign with dignity, if he or she has earned it.