EVALUATING THE CEO

&

BETTER MEASURING OF PERFORMANCE

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Federated Press – 9th Annual
Assessing Board and CEO
Performance Program,
March 26th – 27th, 2007
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1. INTRODUCTION

The turnover of CEOs in North America over the last couple of years has been staggering. In many instances, boards of directors (“boards”) have discovered too late that they had a terrible CEO. In many other instances, boards have discovered too late that they unexpectedly lost a very good CEO. Directors have fiduciary duties to do everything reasonably possible in their overseeing role to minimize the risk of losing a good CEO or finding out soon enough that they have had a really bad one. The worst scenario is discovering too late a terribly bad CEO, and being seriously and personally exposed for not fulfilling their fiduciary duties.

CEO evaluation therefore is viewed as one of the most critical elements in achieving good CEO retention and successful corporate results. Doing it well is not easy. It is often done poorly by many. Great care must be taken (i) in doing it right, (ii) in not overdoing it, resulting in losing a good CEO or (iii) in not underdoing it, ending up continuing with a poor CEO who ultimately should be terminated. It must also be done in a manner that best suits your particular circumstances and objectives.

Many companies in the past did very little to effectively evaluate CEOs and suffered accordingly. Then came along corporate governance regulations, guidelines and public disclosure requirements. This resulted in too many companies just going through the motions of CEO evaluations to meet such requirements, including copying evaluation precedents of other unsimilar companies with much different mandates for CEO evaluations.

Boards of many companies are satisfied with a “Things are going ok” attitude on their CEOs. They may discover too late that they should have taken CEO evaluations much more seriously by following a better evaluation process to determine if they have the right CEO for (1) their particular objectives and strategies (assuming they have nailed these down) and (2) maintaining a successful position in their marketplace with the goal of becoming a leader or maintaining or advancing a leadership position.
All of this begs the questions: What is the profile for the right CEO for your company? What are the best measures in evaluating your CEO’s performance? How capable is your board to evaluate this? What will work best for you? Why? What should you look for and look out for? What should the process be? Who initiates it? Who does it? How competent are they? How independent or unbiased? Walk carefully before you run on these issues and do not forget, the ultimate responsibility in picking, evaluating and maintaining the right CEO lies with the board which is ultimately accountable to shareholders!

2. **START WITH THE RIGHT PREMISES**

- Evaluation starts when you are hiring or working on succession.
- Create the right clear and complete job description. Do not just use a standard form. Particular nuances for your circumstances can later be of utmost importance.
- Have the right employment contract which could later be most helpful.
- The board must clearly understand its role in order to set up the most appropriate CEO evaluation process and to achieve the best results from the process.
- Boards direct, management manage. “Noses in, fingers out!” No micro-managing unless there is a near crisis, a “tipping point” or a crisis.
- “A board can not govern without the willing participation of the governed”.¹
- There has to be respect and trust on both sides – the side of the CEO and the side of the board. Loss of respect either way can be most damaging to achieving the right environment and the right results.
- Good two way communication is vital.
- Make sure there is constant good *follow-up* in the evaluation process.
- The board’s role is to coach, encourage, challenge and demand, and to do it constructively (e.g. criticizing by doing it well).
- Performance of a CEO equates directly with the performance abilities of the board.
- Defining the right evaluation process and purpose: - “different strokes for different folks” - the size, nature and needs of companies vary, but certain

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¹ Good Governance is Substance Over Form (Stephen R. Light), Directors Monthly, National Association of Corporate Directors, January, 2005, page 10.
basics apply to every situation. Learn to distinguish what is best for your situation.

- Do not make the CEO evaluation process a sideline of the compensation review. The objective must be a well run organization with the right CEO leader producing the best value for shareholders not just for the short but also, and even more importantly, for the long run and doing it with integrity with the “right tone” at the top.

- The evaluation process must be continuous and not an annual event.

- Know what skills are most important for your CEO to have and put them in the context of your particular business and circumstances.

- Determine if your CEO or candidate for CEO has “emotional intelligence”\(^2\), one of the most important qualities of a good CEO and one that is often lacking. Emotional intelligence is the quality a good leader has in leading by example with the right tone, combining knowledge and intelligence, effectively combining “head and heart”, resulting in getting the absolute best out of his team, with good motivational skills and a real human sense and tact on how to get the best out of his team.

- A real team approach must be led by the CEO, a truly good captain, not one who uses the word “team” when truly a team does not exist very much because of the CEO:

> “The world moves faster, competition is fierce, and competitors are well educated and experienced. It is neither efficient nor effective for the leader to make all the decisions regarding the actions of an organization.”\(^3\)

- Remember,

> “Leaders create long-term objectives and concepts of the organization’s core beliefs, but a strong leader creates consensus

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> “…research along with other recent studies, clearly show that emotional intelligence is the sine qua non of leadership. Without it, a person can have the best training in the world, an incisive, analytical mind, and an endless supply of smart ideas, but he still won’t make a great leader.”

The article identifies the five components of emotional intelligence at work: self awareness, self-regulation, motivation, empathy and social skills.

\(^3\) *On being a leader. Old rules vs. new rules* (Robert W. MacDonald, retired chairman of Allianz Life of North America) Director & Boards, fourth quarter, 2005, page 33.
that facilitates solutions to setting these objectives and concepts into action.”

- Keep the following observation in mind when evaluating CEOs:

“The leader is a decisive, multifaceted person who lives in the future but acts in the present; is a planner with a clearly communicated purpose who builds alliances that allow others to achieve the vision. The leader is recognized by the followers as ethical, decisive, consistent, communicative, and willing to share the accomplishments with all. Most of all, the leader is one who can be trusted. When the real leader finishes, the pictures on the wall are of the others who make the vision a reality and proved that the leader truly was a leader.”

- Finish off with this CEO evaluation premise:

“Leadership in today’s world calls for a different approach and the “demi God” out front and hell-bent-for-leather may have been the effective image in the past...The modern day CEO develops from a different set of rules:

- When the rule says be out front, allow others to ride the horse.
- When the rule says be the hero, let the others carry the flag.
- When the rule says retain power, make sure power is shared.
- When the rules say know it all, make sure others learn more.
- When the rule says tell people what they do, teach people how to do it.
- When the rule says have all the answers, look for the answers from others.
- When the rule says put the portrait on the wall, put others up first.
- When the rule says take all the credit, give all the credit away.”

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4 footnote 3 (page 33).
5 footnote 3 (page 34).
6 footnote 3, (page 34).
3. WHEN DOES THE CEO EVALUATION ALL START?

The CEO evaluation process all starts with the preparation for hiring a new CEO, defining who you really need, whether you want him or her to be on the board, clearly setting the CEO mandate and goals, thoroughly interviewing prospective CEOs, doing effective due diligence on their past and incorporating all the right provisions clearly in a very complete contract, which will include a very clear job description. Use ingenuity and exceptional care and finesse on the due diligence (e.g. on the validity of the resume check and in the interview).

Too many mistakes are made at this initial stage. Why? They are often rushed. The candidate may have been too smooth and not fully frank. The interviewers themselves may not have been adequately qualified or coached. The references may have been inadequate or inappropriate. Too often the lack of carefully defining who you really need (in relation to other existing good senior management) in your strategic plan can result in the wrong choice.

Then, be sure, as mentioned earlier, to create the right and clear contract which could be most helpful later if things do not turn out to be what you thought they would be.

4. A BLUEPRINT FOR EFFECTIVE CEO PERFORMANCE EVALUATION

Excerpts from the CEO Performance Evaluation chapter of Building Better Boards - A Blueprint For Effective Governance (by David A. Nadler, Beverly A. Behen and Mark B. Nadler, editors) published by Mercer Delta Consulting

The best condensed presentation on CEO performance evaluation that I can recommend to you is in the CEO Performance Evaluation chapter of the recently released book “Building Better Boards - A Blueprint For Effective Governance” (by David A. Nadler, Beverly A. Behen and Mark B. Nadler, editors) published by Mercer Delta Consulting. It is ranked as “A Must Read” (Anne Mulcahy, Chairman and CEO, Xerox Corporation). This chapter serves as an excellent model for my presentation today. I encourage the participants in this program to get a copy of the book. I am sure that you will value doing so very much.

Building Better Boards - A Blueprint For Effective Governance is based not only on the expertise in corporate governance of its editors, but also on (1) Mercer Delta Consulting’s unparalleled experience in working with top corporate leaders; (2) vigorous research conducted with the University of Southern California’s Marshall School of Business; (3) working with the renowned National Association of Corporate Directors of the United States and their Blue Ribbon Commissions, a broad-based Commission composed of about fifty directors, CEOs, chairmen, academics and corporate governance experts; (4) in-depth one-on-one interviews; and (5) a Canadian perspective. The editors have also drawn on the expertise of Jay W. Lorsch, an internationally recognized expert on boards, a professor of the Harvard Business School, who has written the forward for Building Better Boards. Lorsch is also the co-author of another
highly recommended book on boards entitled *Back to the Drawing Board, Designing Corporate Boards for a Complex World*.7

To assist you today, appended to this presentation are the following Exhibits and Illustrations contained in the CEO Performance Evaluation chapter:

- On defining performance dimensions and measures: *CEO Evaluation Time Line* and *CEO Evaluation Process Review*.
- On gathering assessment feedback: *Multisource CEO Feedback at a Chemical Plant*.

They serve as excellent reference points for our review today in the context of what I have previously outlined.

You certainly get the common sense message that by building better boards you achieve in having better CEOs. I encourage you, sooner rather than later, to study the CEO Performance Evaluation chapter in the context of the book as a whole.

The CEO Performance Evaluation chapter leads off by making a fundamental point that needs repeating: the mere compliance with minimal required or recommended regulatory standards for CEO appraisals is no guarantee of a better or even good governance. It highlights that a lack of essential features in a CEO evaluation model will result in not seeing early warning signals that should have been addressed long before they reach crisis proportions and that the CEO evaluation process is a fragile one. It emphasizes that CEO evaluation is much more than just grading the CEO at the end of each year based on a narrow list of financial goals. It is pointed out that:

- “...essential steps each board should take as it designs its own CEO evaluation process:
  - Creating a shared understanding of the purpose of CEO appraisal.
  - Designing a sequenced process for identifying goals, monitoring progress, and assessing year-end performance, then agreeing on who should play which roles.
  - Identifying the appropriate areas on which to rate the CEO’s performance.

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Deciding the best way to gather data on the difficult-to-measure nonfinancial performance dimensions.

Communicating effectively with the CEO on performance-related issues.”

“The problem with a really good evaluation is that it takes an enormous amount of time and knowledge, and it is not easily based on quantifiable things” and that “Beyond that, there’s a very human dimension to the process, a potential clash of egos and interests that go to the very heart of the changing relationship and the shifting balance of power between CEOs and boards”. They indicate that the process is a fragile one, and very appropriately point out that:

- There is an appraisal paradox – the more senior the executive, and the greater his/her impact on the organization’s performance, the less vigorous the evaluation process.

- Many CEOs may view their boards as their boss strictly in an abstract legal sense.

- There is a distinctly personal dimension in assessing CEOs – (e.g. usually strong, powerful people, by nature, find it emotionally difficult to accept critical feedback).

- Some directors are intimidated.

- Directors must face their challenge head-on.

On The Context of CEO Performance and Accountability, it is stated that:

“Never in recent memory has CEO performance been the subject of such intense scrutiny or broad concern as it is today. Little wonder, then, that the board’s role in overseeing CEO performance has emerged as a significant component of governance reform” and that “the overall process is fairly straightforward, but will vary from one company to the next, shaped by personalities, history, and strategic context; there is no one-size-fits-all solution” and that again “the process is fragile”.

In addressing Clarifying the Purpose of the Process, it is emphasized that it is important (1) to establish clear objectives with a clear focus on the company’s future direction by specifying strategic objectives and performance metrics for the year ahead

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8 footnote 7 (page 150).
9 footnote 7 (page 151).
10 footnote 7 (page 152).
and (2) to set goals and provide ongoing feedback in areas where the CEO needs to change behaviour, learn new skills, or focus additional attention, and that (3) all of this leads to better decisions on the CEO’s compensation and continued employment.\footnote{7 (pages 152-153).}

- On board oversight legal responsibility, it is appropriately stated that the board’s legal “oversight role does not require any attention to whether the CEO possesses the vision, strategy, and personal capabilities to achieve the performance objectives.”\footnote{7 (page 153).} [Note: It is this attention that makes the difference between a board doing a really good CEO evaluation and an average or poor one.]

- Caution is expressed on time constraints and on distinguishing between a review of past performance for compensation and an assessment of a CEO’s personal strengths and weaknesses, combined with separate distinct developmental discussions on future objectives.

- Caution is also expressed on making sure that such developmental discussions do not get a short shrift.

- On the subject of \textbf{Implementing the CEO Advisory and Process: Critical Roles and Activities}, it is emphasized that there is no particular model for structuring the CEO evaluation process but that they all share two elements: (1) a fairly detailed formal process with a sequenced calendar of events and (2) best processes are characterized by careful attention to who should be involved, in what roles, at every stage, and that

  - There is an absolute need for a specific director (either the chairman of the compensation committee, a lead director, or the non-executive chairman) to clearly assume the lead role for the assessment process and that the entire board should contribute; and that

  - An assessment process usually begins before the start of the fiscal year during which:

    “…the CEO formulates an initial set of personal performance targets, specifying how progress against each target will be measured, and submits the plan to the board”.\footnote{7 (page 154).}

- On \textbf{Ongoing Assessments}, it points out, among other important things, that:

  - “At the very least the compensation committee and the board should sit down six months into the year and take time to review the targets and progress against them.”\footnote{7 (page 155).} – [Note: This is a very critical approach: trying to make sure that the
CEOs and the board stay on the same page and deal with the problems before they reach a breaking point.

- **On Year-End Assessments**, it (1) recommends entire board involvement, (2) points out that the most difficult element of the year-end assessment is the actual communication of its content to the CEO and (3) that the provision of a worksheet on the CEO’s evaluation timeline is most helpful.

- **On Defining Performance Dimensions and Measures**, some highlights of their observations are as follows:

  - “The defining element of any component of the appraisal process – whether for compensation decisions, goal setting, or developmental feedback – is the specific set of dimensions on which the CEO will be evaluated…. “These form the basis of all the measures, objectives and targets used in the process…. Among all the decisions that must be made throughout the process, the selection of performance dimensions, and the relevant weighting given to each, is probably the most challenging because it forces the board to sort through the complex relationship between the CEO’s personal effectiveness and the organization’s collective performance.”

  - It is reiterated that:

    “Hitting the metrics around financials is not a complete review…. These metrics are just the entry point. There needs to be more emphasis on character issues, so meeting metrics is not taken to mean that the assessment is complete. The board needs to dive into issues of developing a bench, integrity, leadership strength, and building a coffer for the long haul.”

- **On Bottom-Line Impact**, it is astutely pointed out, that:

  “Over the years, the inherent irony of CEO performance appraisal is that it has placed the greatest emphasis on the set of measures over which the CEO exerts the least direct influence: short-term

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15 footnote 7 (page 156), quoting in part one of those surveyed for the book.
16 footnote 7 (page 157).
17 footnote 7 (pages 157 and 160).
18 footnote 7 (page 160), quoting one of those surveyed for the book.
financial performance. … Yet, the underlying assumption of many CEO evaluation and ‘pay-for-performance’ plans is the highly questionable proposition that a CEO’s actions have a direct, immediate and significant impact on the company’s financial performance and stock price… it’s incredibly difficult to accurately measure the CEO’s short-term impact on the financial performance of a complex organization – but that does not stop boards from trying…. These bottom-line measures have severe deficiencies as sole indicators of CEO performance. As the person at the top supposedly ‘pulling all the levers,’ CEOs are acutely aware that the impact of their own personal actions on the company’s bottom line is far from direct, rarely immediate, and seldom dramatic.” 19

I would add that the very good Illustrations, attached, in the CEO Performance Evaluations chapter, effectively capture the bottom-line impact dimensions used in CEO evaluation and the CEO’s impact on company operations and the bottom-line. They also verify the truth of the Chinese adage “A picture is worth a thousand words.”

- **On Operational Impact**, the CEO Performance Evaluation chapter neatly addresses the CEO’s personal effect on the company’s operational and organizational effectiveness and raise a leading question: “Has the CEO made changes that either improve or diminish the organization’s ability to function and perform effectively?” The Figure 8.4 Illustration, attached20, describes the operational impact dimensions as “most important in evaluating CEO performance.”

- **On Leadership Effectiveness**, the chapter focuses on the CEO’s personal behaviour and actions, which in turn influence the operational impact, and ultimately, the bottom-line impact, and states that:

  “This area involves an assessment of the CEO’s personal interactions with the entire range of internal and external constituencies. Internally, it relates to the CEO’s effectiveness in developing strategy, talent, and culture. Externally, it measures the CEO’s performance as the organization’s face to the world and the key player in shaping its reputation and relationships with key stakeholders.”

- **On Selecting Objectives and Specifying Measures**, it is pointed out, as previously mentioned, that such objectives and measures “will vary for each company, and in fact, ought to vary to a certain extent from one year to the next…” and

  - Highlights the subjects of “Strategic Leadership,” “Enterprise Guardianship” (including setting the tone at the top) and “board Relationship” (involving

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19 footnote 7 (pages 160-161).
20 page 21
21 footnote 7 (page 164).
working collaboratively, timely information and full and informed consent about matters).

- Highlights being sure to look beyond bottom-line performance.
- Highlights the need to be limiting the objectives to manageable number (since things can quickly get out of hand, resulting in your losing focus, and that typically, a set of four to six major strategic items are plenty).
- Provides good advice on how to handle matters when the same person is both chairman and CEO (noting separate objectives for each role).
- Identifies the importance of defining the measure for each objective and clearly relating performance to rewards.\(^{22}\)

- **On Gathering Assessment Feedback**, it emphasizes the need to effectively involve outside parties as sources of information or as facilitators of the process and the need for multi-source feedback.\(^{23}\)

- **On Communicating with the CEO**, it reiterates that there are several critical junctures at which the entire appraisal process can fall apart, and that the final communication of the assessment may be the most fragile of all. The chapter outlines useful steps to follow (e.g., how the messages are conveyed is as important as the messages themselves), and astutely notes:
  - The importance of selecting the right person to deliver the message;
  - That: “Interestingly, a number of CEOs on the Commission expressed a strong preference for having the feedback delivered by the entire board, rather than by one or two individuals”; and that
  - “One final concern raised by a number of Commission members is the need to ensure that the delivery of the appraisal is a rigorous and ‘more formal process,’ rather than ‘between you and me.’”\(^{24}\)

- The CEO evaluation concludes with the following points:
  - The rigorous, systematic approach to CEO appraisal as presented in the chapter is emblematic of the changing nature of corporate governance.
  - It is long overdue that:

\(^{22}\) footnote 7 (pages 164-166).
\(^{23}\) footnote 7 (page 167).
\(^{24}\) footnote 7 (pages 169-170).
“…a growing interest in a rigorous appraisal process that takes into account the complexity of the CEO’s job and the variety of ways in which the CEO’s behaviour and decisions influence the organization’s overall performance.”

5. ADDITIONAL POINTS TO BE MADE

Different Strokes For Different Folks

It is important to re-emphasize the point that effective CEO evaluations may be quite different from company to company. Each board has its own unique situation. Some may be far more complex and time consuming than others and some may involve far more paperwork and verifications than others. There is no one-size-fits-all. The “keep it simple but effective” approach can apply to various CEO evaluation processes.

For example, one company on which I serve as a director has a very good tightly knit board of five directors, three of whom are independent. The board is a very “hands on” board but not in a micro-managing way. The board has had a firm grip on the CEO evaluation process, performance dimensions and the weighting of various performance dimensions. The board constantly assesses the strengths, weaknesses and solution approaches of the CEO in accordance with the mandate of the corporate governance committee. This involves full and frank dialogues with the CEO throughout the year. It is separate and apart from the CEO compensation review. The corporate governance committee takes the lead on the CEO evaluation during the year.

Then, in lieu of having the questionnaire completion process by each director, we prepare a CEO evaluation criteria memorandum for board members to consider, backed by actual performance reports. A meeting is then held (or a significant part of a meeting is set aside) for a full and frank CEO evaluation by the independent directors. At the appropriate time and in the appropriate manner, after the full and frank meeting, a full and frank session is held with the CEO with at least two of the independent directors. Throughout, there is constructive candour. The CEO completely buys into the process. This overall process is most helpful and constructive both for the CEO and the board. I reiterate that conventional ways or beliefs for some CEO evaluations are not necessarily the best for everyone. On occasion a variation may be the best approach. The importance is that the objectives and substance are the same and that the process is best suited for the particular company.

\footnote{footnote 7 (page 171).}
6. **INTEGRAL PART OF THE CEO EVALUATION — WATCH OUT FOR CLUES — POSITIVE INDICATORS OR NEGATIVE WARNINGS ON CHARACTER, QUALITIES AND TALENTS OF A CEO OR A LACK THEREOF.**

Generally, you must look to see if your CEO is a true team leader with a combination of most of the following positive qualities and talents or to see that he or she improves on some that may be missing. This should be done by effective board diligence and coaching:

**POSITIVE INDICATORS**

- Has emotional intelligence, vision and integrity and is a team builder and leader highly respected and trusted by those around her or him.
- Has respect for the board and its role.
- Handles successes, setbacks and failures well
- Has good communication with the board:
  - timely material information, operationally and strategically for the short and long term
  - good information
  - presentations are complete, to the point and allow necessary dialogue with the board, not death by limited and speedy PowerPoint
  - recognizes that a board meeting is a board’s meeting and the agenda is the board’s agenda and the board’s responsibility, and he or she effectively helps the board set the agenda and does not just tell the board what the agenda will be
  - not autocratic, authoritarian or imperial
  - brings in his team members as necessary
  - calls on other senior officers to report directly to the board
  - is the first one you want to go to for information or answers you are seeking
  - provides good feedback for the board
  - good collaboration with the board
- Has industry smarts or has those around him with it and knows how to draw on it

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26 See references attached to this presentation.
• Other Personal Traits:
  o a people person
  o a quick learner
  o likes to be challenged
  o has real drive
  o works well under pressure
  o tough when she or he needs to be
  o takes criticism well
  o knows his or her strengths and admits his or her weaknesses and has an insatiable appetite to improve
  o honest and frank
  o a motivator
  o good listener, straight talker

• On ethics:
  o emphasizes proper ethics
    o practices what she or he preaches
    o wants to do what is right, not clever, in dealing with questionable areas or practice

• Dealing With Shareholders, The Public, Peers And Employees
  • good with shareholders and the public
  • a good public speaker
  • employees and peers highly respect him or her and evidence this with tremendous supportive action

NEGATIVE WARNINGS
• Has little or no emotional intelligence, little vision, signs of questionable integrity and does not appear to have the confidence or respect of key management
• Does not handle setbacks or failures well
• Conduct or body language reveals a negative attitude toward the board

• Poor communication:
  o monopolizes board meetings too much
  o appears to not value the input of the board (assumption: it is a good board), views the board as a necessary evil
  o poor collaboration, too often in disagreement with the board on who should do what on activities between them
  o tries to control the agendas of board meetings or has someone else assisting the board on the board’s agendas
  o creates concern of the board as to whether or not the board is getting the full truth
  o information not timely or complete
  o not enough timely operational and strategic input for the short and long term
  o poor feedback
  o biased presentations (not enough pros and cons)
  o presentations made on a “death by PowerPoint” basis, abusing the advantages of PowerPoint, resulting in insufficient full and frank discussion in board meetings
  o overrides other senior officers in reporting to the board

• Does not like “hands on” directors (who are not micro-managing or not trying to do day-to-day responsibilities of management)

• Autocratic or imperial and too authoritarian

• Does not know industry well but thinks he or she does, and either does not have good industry people around him or her or does not listen to them

• **Other Personal Traits**
  o a control freak with an insatiable need
  o not the kind of person who can truly change
  o ego problem, not a good listener and does not like to be questioned
  o weak under pressure
  o a nervous nelly
• blame others too often
• will not admit faults, excuses galore
• too pre-occupied with getting compensation increases and not the necessary results; makes excuses or tries to inappropriately get the pre-agreed compensation formula changed when things are not going well
• repeatedly has excessive entertainment expenses and does not seem to want to change or is caught once or more than once with improper expenses that he or she knew or should have known were improper (material or not so material).

• **On Ethics:**
  • seeks to do what is clever in dealing with “grey” areas
  • creates concern as to whether he or she may not be a person of true integrity
  • treats organizational integrity as a matter of legal compliance rather than a core value of the company
  • does not appear to “walk the ethics talk”

**Dealing with Shareholders, the Public, Employees and Peers**

• Not up to top form in dealing with shareholders and the public and not a particularly good public speaker

• Employees and peers do not appear to sufficiently endorse her or him.

There is an optimistic adage “Turn a negative into a positive!” Unfortunately some people cannot change, particularly characteristically speaking. However, they may “act” well, but sooner or later, you will see through them for what they really are. Boards should not linger in dealing with negatives.

7. **CONCLUSIONS ON THE CEO EVALUATION**

Boards generally must do a better job of CEO evaluations in order to fulfil their overseeing responsibilities. Doing that little extra can pay off and lead to the right compensation decision, and more importantly, should lead to the appropriate performance standards and assessment process being set for a CEO.

If such standards are not materially met by a CEO, a board should leave no room for procrastination on having the CEO materially meet the absolutely essential standards in a reasonably time frame.

The CEO evaluation approach outlined in this presentation should stimulate a positive learning culture vs. creating a threatening or intimidating atmosphere. It is geared to
produce reliable data and a solid basis for sound judgment on CEO performance. It should have a genuine positive impact on CEO performance and consequently on overall business performance.

It certainly is not a process and application that just “goes through the motions”. It goes to the pith and substance of evaluating CEOs in terms of leadership, communication and administration; and applies a process that draws out for a board the crucial indicators of a CEO’s character, qualities and talents, or lack thereof. It provides for a board the right ingredients to make the right decisions on the CEO, including compensation decisions.
8. DIAGRAMS FROM CEO Performance Evaluation Chapter

CEO Evaluation Time Line

Figure 8.1. CEO Evaluation Time Line.

Before start of fiscal year

Step One
- Management team develops strategic plan.
- CEO specifies personal performance objectives tied to measurable targets and performance levels.
- Compensation committee reviews targets.
- CEO communicates target down to management team.

End of fiscal year

Step Three
- CEO self-evaluation circulated: adviser comments synthesized.
- Compensation committee uses evaluation to help determine pay and shares result with the CEO.
- Evaluation process is reviewed and adjusted as necessary for the next year.

Start of fiscal year

Ongoing Assessment

Step Two
- CEO and board review performance.

Third quarter

Second quarter

First quarter
CEO Evaluation Process Review

Exhibit 8.1. CEO Evaluation Process Review.

Purpose: This worksheet is designed to assess the quality and comprehensiveness of a CEO evaluation process. The questions are derived from best practices in three areas: the process of evaluation, relevant roles during the process, and the content of the evaluation itself.

Instructions: Enter Yes, No, or N/A (Not Applicable) in the rating column.

### PROCEDURAL ELEMENTS

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Rating</th>
<th>Comments</th>
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<tr>
<td>1. Is there an explicit description of the CEO evaluation process with articulated goals, roles, and responsibilities?</td>
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<td>2. Is there an explicit process calendar with detailed deadlines and milestones?</td>
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<th>Criteria</th>
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<th>Comments</th>
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<td>3. Is the process calendar aligned with the corporate calendar (i.e., do CEO evaluation events fit with pre-existing governance and management schedules)?</td>
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<td>4. Does the process include a midyear check-in on CEO performance?</td>
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<tr>
<td>5. Does the process include a focus on CEO development and opportunities for developmental feedback?</td>
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<td>6. Is the process consistent with the company's values and culture?</td>
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<td>7. Does the process include quality assurance mechanisms that allow it to be revised as needed?</td>
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### ROLES AND RESPONSIBILITIES

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<td>8. Does the process have a clearly defined leader?</td>
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<td>9. Is the process sufficiently controlled (led and managed) by outside directors to preserve the integrity of the evaluation?</td>
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<tr>
<td>10. Is there a clearly defined role (or external consultant) for the collecting and compiling of performance data, ratings, etc.?</td>
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<tr>
<td>11. Is the CEO considered a partner at each stage of the process, with ample opportunity for input?</td>
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<tr>
<td>12. Are the people with the most valid information about the CEO's actions and leadership impact given the opportunity to provide feedback?</td>
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<tr>
<td>13. Has the feedback deliverer been identified? Does this person have the skills required to effectively deliver CEO performance feedback?</td>
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### CONTENT AND MEASURES

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<tr>
<td>14. Have performance standards and criteria for evaluating the CEO been identified and made explicit?</td>
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<tr>
<td>15. Are all relevant aspects of CEO performance included in the performance criteria?</td>
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<td>16. Do performance criteria encompass both CEO and chairman roles?</td>
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<td>17. Is there a clear link between the performance criteria that make up the evaluation and the company's strategic objectives and business requirements?</td>
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<td>18. Can the business rationale be articulated for each performance criterion?</td>
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<tr>
<td>19. Is there a valid, feasible measure identified for each relevant performance criterion?</td>
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<tr>
<td>20. Are statistically sound methods used to gather and interpret performance data?</td>
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Bottom-Line Impact Dimensions Used in CEO Evaluation

- Net Operating Revenues
- Operating Cash Flow
- Net Income
- Net Operating Revenues
- Earnings Per Share
- Capital Expenditures
- Share Price

Figure 8.2: Bottom-Line Impact Dimensions Used in CEO Evaluation.
The CEO’s Impact on Company Operations and the Bottom Line

Figure 6.3: The CEO’s Impact on Company Operations and the Bottom Line

Most Important Dimensions of Operational Impact, per Corporate Directors Survey
Figure 3.1. Director Peer-Review Feedback Report: Survey Methodology.

Source: “Building Better Boards - A Blueprint For Effective Governance” (by David A. Nadler, Beverly A. Bexton and Mark B. Nadler, editors) published by Mercer Delta Consulting
9. REFERENCES

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