

# Guidance on Board Effectiveness

## Handbook for State-Owned Enterprises (EE, LV, LT)

October 2013

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## Executive Summary

State-Owned Enterprises (SOE's) are an important part of the economy in the Baltic States, how they are managed and governed impact the economy and set the tone at the top for not only for SOE's but for the private sector as well.

In June 2010 the Baltic Institute of Corporate Governance published "Baltic Guidance on the Governance of Government-owned Enterprises" this was intended as a road map for the Governments to bridge the GAP between current practices and OECD Guidelines on Corporate Governance of State Owned Enterprises.

In May 2012 we published Governance of State-owned Enterprises in the Baltic States, intended as a rating of reform progress both in companies, legal framework and public opinion.

This new handbook has been developed to improve the work in the boards of the SOE's in Estonia, Latvia and Lithuania and help the parties involved create international best practice boards.

The handbook is an adaptation of the Financial Reporting Council (UK), "Guidance on Board Effectiveness" originally published in March 2011. The appendix section mainly draws from the preceding document from FRC, "Good Practice Suggestions from the Higgs Report" We thank the FRC for their generous support in allowing BICG to adopt their documents for this purpose. We also want to thank ICSA (the Institute of Chartered Secretaries and Administrators) who originally developed these documents for the FRC for their support to BICG.

In particular we would like to thank Mr. Chris Hodge from the FRC and Mr. Seamus Gillen from ICSA who has supported BICG continuously.

BICG also wishes to thank the OECD and in particular Mr. Hans Christiansen for his tireless support to BICG.

We have added our own comments and references to this very relevant guidance, and hope that it will support better quality boards in our SOE's.

The target audience for the handbook is current and future board members, both when they are from the public sector and the board assignment is a part of their day-to-day job, and when they are independent board members from outside the Government. We also believe this handbook will be valuable for Government Ministers, officials and Parliamentarians that are overseeing SOE's and perhaps are involved in nominating board members and communicating with the SOE's.

Finally the handbook should act as a window to the public, so they might understand what to expect when we manage these valuable assets on their behalf.

The Baltic Institute of Corporate Governance supported by Stockholm School of Economics in Riga developed the handbook. We want to thank Baiba Lokenbaha, Santa Griva and Martins Sillis for the excellent and dedicated work. We also want to thank the many people who contributed with their knowledge, experience and suggestions.

October 9, 2013

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# One – The Role of the Board and Directors

## An Effective Board

- 1.1 The board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed.
- 1.2 An effective board develops and promotes its collective vision of the company's purpose, its culture, its values and the behaviours it wishes to promote in conducting its business. In particular it:
  - provides direction for management;
  - demonstrates ethical leadership, displaying – and promoting throughout the company - behaviours consistent with the culture and values it has defined for the organisation;
  - creates a performance culture that drives value creation without exposing the company to excessive risk of value destruction;
  - makes well - informed and high - quality decisions based on a clear line of sight into the business;
  - is accountable, particularly to those that provide the company's capital; and
  - thinks carefully about its governance arrangements and embraces evaluation of their effectiveness.
- 1.3 An effective board should not necessarily be a comfortable place. Challenge, as well as teamwork, is an essential feature. Diversity in board composition is an important driver of a board's effectiveness, creating a breadth of perspective among directors, and breaking down a tendency towards 'group think'.
- 1.4 An effective board should create a board mandate, which is a clear list of board responsibilities, so there is clarity as to what is the responsibility of the board and what is the responsibility of the management. Developing such a list is a useful way of ensuring that everyone understands their role and is not stepping on anyone's toes, and that there are no surprises.<sup>1</sup>
- 1.5 An effective board should establish several committees that are responsible for company specific matters.<sup>2</sup> Commonly established committees include audit, remuneration, risk, reserves and governance committee etc.

## The Role of the Chairman

- 1.6 Good boards are created by good chairmen. The chairman creates the conditions for overall board and individual director effectiveness.
- 1.7 The chairman should demonstrate the highest standards of integrity and probity, and set clear expectations concerning the company's culture, values and behaviours, and the style and tone of board discussions.
- 1.8 The chairman, with the help of the executive directors and the company secretary, sets the agenda for the board's deliberations.

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<sup>1</sup> OECD. Using the OECD Principles of Corporate Governance. Boardroom Perspective.

<sup>2</sup> OECD. The Board of Directors: Composition, Structure, Duties and Powers.

## 1.9 The chairman's role includes:

- Demonstrating ethical leadership;
- Setting a board agenda which is primarily focused on strategy, performance, value creation and accountability, and ensuring that issues relevant to these areas are reserved for board decision;
- Ensuring a timely flow of high-quality supporting information;
- Making certain that the board determines the nature, and extent, of the significant risks the company is willing to embrace in the implementation of its strategy, and that there are no 'no go' areas which prevent directors from operating effective oversight in this area;
- Regularly considering succession planning and the composition of the board;
- Making certain that the board has effective decision-making processes and applies sufficient challenge to major proposals;
- Ensuring the board's committees are properly structured with appropriate terms of reference;
- Encouraging all board members to engage in board and committee meetings by drawing on their skills, experience, knowledge and, where appropriate, independence;
- Fostering relationships founded on mutual respect and open communication – both in and outside the boardroom – between the non-executive directors and the executive team;
- Developing productive working relationships with all executive directors, and the CEO in particular, providing support and advice while respecting executive responsibility;
- Taking the lead on issues of director development, including through induction programmes for new directors and regular reviews with all directors;
- Acting on the results of board evaluation;
- Being aware of, and responding to, his or her own development needs, including people and other skills, especially when taking on the role for the first time; and
- Ensuring effective communication with shareholders and other stakeholders and, in particular, that all directors are made aware of the views of those who provide the company's capital.

1.10 The chairman of each board committee fulfils an important leadership role similar to that of the chairman of the board, particularly in creating the conditions for overall committee and individual director effectiveness.

1.11 The chairman of the board has to be more than just a nominal leader. A good chairman needs to perform many functions in practice, among other things serving as an effective team builder, a motivator, a diplomat and a conflict solver. In addition, the chair of a BOD for a state-owned enterprise is required to reconcile the needs and opinions of the government, SOE executives, and the board, retaining the trust of all parties and keeping political pressures away from proceedings of the board. Ideally, the chairman would also be capable of performing gap analysis of the board (identifying missing skills and competencies) and carrying out interviews with board candidates. This requires an exceptionally strong individual and a large time commitment, meaning that the selection of the chairman is of invaluable importance.<sup>3</sup>

1.12 OECD Guidelines regarding the governance of SOEs specify the chairman and CEO roles must be separated. Ensuring this separation “helps in achieving an appropriate balance of power, increasing accountability and improving the board’s capacity for decision making independent of management”. Furthermore, it is especially important when appointing the chairman of SOEs because “it is usually considered necessary to empower the board’s independence from management”. In this capacity, the chairman must fulfil the role of guiding the board with an emphasis on strategic considerations. The separation of the Chairman from management is an essential step in ensuring s/he is capable of fulfilling the requirements demanded by the Chair position in the unique SOE situation.<sup>4</sup>

## **The Role of Executive Directors**

1.13 Executive directors have the same duties as other members of a unitary board. These duties extend to the whole of the business, and not just that part of it covered by their individual executive roles. Nor should executive directors see themselves only as members of the CEO’s executive team when engaged in board business. Taking the wider view can help achieve the advantage of a unitary system: greater knowledge, involvement and commitment at the point of decision. The chairman should make certain that executives are aware of their wider responsibilities when joining the board, and ensure they receive appropriate introduction and regular training, to enable them to fulfil the role. Executive directors are also likely to be able to broaden their understanding of their board responsibilities if they take up a non-executive director position on another board.

1.14 The CEO is the most senior executive director on the board with responsibility for proposing strategy to the board, and for delivering the strategy as agreed. The CEO’s relationship with the chairman is a key relationship that can help the board be more effective. The differing responsibilities of the chairman and the CEO should be set out in writing and agreed by the board. Particular attention should be paid to areas of potential overlap.

1.15 The CEO has, with the support of the executive team, primary responsibility for setting an example to the company’s employees, and communicating to them the expectations of the board in relation to the company’s culture, values and behaviours. The CEO is responsible for supporting the chairman to make certain that appropriate standards of governance permeate through all parts of the organisation. The CEO will make certain that the board is made aware, when appropriate, of the views of employees on issues of relevance to the business.

1.16 The CEO will ensure the board knows the executive directors’ views on business issues in order to improve the standard of discussion in the boardroom and, prior to final decision on an issue, explain in a balanced way any divergence of view in the executive team.

1.17 The CFO has a particular responsibility to deliver high-quality information to the board on the financial position of the company.

1.18 Executive directors have the most intimate knowledge of the company and its capabilities when developing and presenting proposals, and when exercising judgement, particularly on matters of strategy. They should appreciate that constructive challenge from non-executive directors is an essential aspect of good governance, and should encourage their non-executive colleagues to test their proposals in the light of the non-executives’ wider experience outside the company. The chairman and the CEO should ensure that this process is properly followed.

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<sup>4</sup> OECD Guidelines on Corporate Governance of State Owned Enterprises.

## The Role of Non-Executive Directors

- 1.19 A non-executive director should, on appointment, devote time to a comprehensive, formal and tailored introduction, which should extend beyond the boardroom. Initiatives such as partnering a non-executive director with an executive board member may speed up the process of him or her acquiring an understanding of the main areas of business activity, especially areas involving significant risk. The director should expect to visit, and talk with, senior and middle managers in these areas.
- 1.20 Non-executive directors should devote time to developing and refreshing their knowledge and skills, including those of communication, to ensure that they continue to make a positive contribution to the board. Being well-informed about the company, and having a strong command of the issues relevant to the business, will generate the respect of the other directors.
- 1.21 Non-executive directors have a responsibility to uphold high standards of integrity and probity. They should support the chairman and executive directors in instilling the appropriate culture, values and behaviours in the boardroom and beyond.
- 1.22 Non-executive directors should insist on receiving high-quality information sufficiently in advance so that there can be thorough consideration of the issues prior to, and informed debate and challenge at, board meetings. High-quality information is that which is appropriate for making decisions on the issue at hand – it should be accurate, clear, comprehensive, up-to-date and timely; contain a summary of the contents of any paper; and inform the director of what is expected of him or her on that issue.
- 1.23 Non-executive directors should take into account the views of shareholders and other stakeholders, because these views may provide different perspectives on the company and its performance.

## The Role of Independent Directors<sup>5,6</sup>

- 1.24 Independence remains one of the most sought after characteristics in board members. Best practice has been to have a significant number of independent board members on the SOE board.
- 1.25 Independence' may be defined simply as economic independence from the company and an absence of political connections. A system of independent directors is the essence of the listed company, but to work as designed, independent directors should keep their independence in all respects.
- 1.26 Independent directors add value based on their outside experience and ability to raise difficult questions. Independent directors should be more or less generalists, and able to use common sense based on understanding of the industry and the company.
- 1.27 It is critical for boards of enterprises with state ownership to include directors who are truly independent and have excellent reputations, experience and networks. A person who feels confident and strong in his or her function is better able to step into discussions, stand up for the interests of the company and raise questions when state-nominated directors act as instructed by the state.
- 1.28 A problem with achieving the benefits of independence is overly restrictive and mechanical definitions of independence that hinder finding individuals capable of the objective thought that should be the final outcome. Greater emphasis should be placed on the capacity of the individual to contribute in an objective and unbiased fashion, and searches should focus more on personality characteristics and not rely on a mechanistic evaluation of the CV compared to checklist definitions.

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<sup>5</sup> OECD Boards of Directors of State-Owned Enterprises - An Overview of National Practices.

<sup>6</sup> OECD. Using the OECD Principles of Corporate Governance. Boardroom Perspective.

## Two – Decision Making

- 2.1 Well-informed and high-quality decision-making is a critical requirement for a board to be effective and does not happen by accident. Flawed decisions can be made with the best of intentions, with competent individuals believing passionately that they are making a sound judgment, when they are not. Many of the factors which lead to poor decision making are predictable and preventable. Boards can minimise the risk of poor decisions by investing time in the design of their decision-making policies and processes, including the contribution of committees.
- 2.2 Good decision-making capability can be facilitated by:
- high-quality board documentation;
  - obtaining expert opinions when necessary;
  - allowing time for debate and challenge, especially for complex, contentious or business-critical issues;
  - achieving timely closure; and
  - providing clarity on the actions required, and timescales and responsibilities.
- 2.3 Boards should be aware of factors, which can limit effective decision-making, such as:
- A dominant personality or group of directors on the board, which can inhibit contribution from other directors;
  - Insufficient attention to risk, and treating risk as a compliance issue rather than as part of the decision-making process, especially in cases where the level of risk involved in a project could endanger the stability and sustainability of the business itself;
  - Failure to recognise the value implications of running the business on the basis of self-interest and other poor ethical standards;
  - A reluctance to involve non-executive directors, or of matters being brought to the board for sign-off rather than debate;
  - Complacent or intransigent attitudes;
  - A weak organisational culture;
  - Inadequate information or analysis.



- 2.4 Most complex decisions depend on judgment, but the judgment of even the best-intentioned and experienced leaders can, in certain circumstances, be distorted. Some factors known to distort judgment in decision making are conflicts of interest, emotional attachments, and inappropriate reliance on previous experience and previous decisions. For significant decisions, therefore, a board may wish to consider extra steps, for example:
- Describing in board papers the process that has been used to arrive at and challenge the proposal prior to presenting it to the board, thereby allowing directors not involved in the project to assess the appropriateness of the process as a precursor to assessing the merits of the project itself; or
  - Where appropriate, putting in place additional safeguards to reduce the risk of distorted judgements by, for example, commissioning an independent report, seeking advice from an expert, introducing a devil's advocate to provide challenge, establishing a sole purpose sub-committee, or convening additional meetings. Some chairmen favour separate discussions for important decisions; for example, concept, proposal for discussion, proposal for decision. This gives executive directors more opportunity to put the case at the earlier stages, and all directors the opportunity to share concerns or challenge assumptions well in advance of the point of decision.
- 2.5 Boards can benefit from reviewing past decisions, particularly ones with poor outcomes. A review should not focus just on the merits of the decision itself but also on the decision-making process.

## Three - Board Composition and Succession Planning

- 3.1 Appointing directors who are able to make a positive contribution is one of the key elements of board effectiveness. Directors will be more likely to make good decisions and maximise the opportunities for the company's success in the longer term if the right skill sets are present in the boardroom. This includes the appropriate range and balance of skills, experience, knowledge and independence. Non-executive directors should possess critical skills of value to the board and relevant to the challenges facing the company.

The composition of the SOE board is crucial for its performance. We thus attempt to outline specific skills and competencies that should be sought after in board members-to-be. As a general note, appointing civil servants and, in particular, politicians to SOE boards is increasingly frowned upon in OECD countries, as they are expected to be subject to conflict of interest and often unable to contribute to open-minded discussion.

However, **Political skills and understanding** should be valued highly in board members. An explicit knowledge of the workings of the government, often lacking for private sector representatives, can be essential in strengthening cooperation between an SOE and the government. Such individuals can serve as a link between the two, building mutual trust and understanding. As far as concerns about such individuals politicizing the board go, this will depend on their ability to retain independence. Board members with political knowledge are thus likely to add value to the board, as long as they are carefully selected.

**Independence** is perhaps the most important characteristic in a board member. When nominating board members, one should avoid relying on overly restrictive definitions of independence, as this may complicate identifying the individuals most capable of objective thought, which is the ultimate objective here. The evaluation of board members for independence should focus on personality characteristics rather than a mechanistic comparison between a candidate's CV and checklist definitions.

**Private sector experience** is essential, ideally stemming from work in a listed or international company. Board members currently employed in private companies and their understanding of up-to-date business practices are instrumental in providing a welcome counterbalance to people who perform board duties full-time. Involving CEOs of private sector companies is highly beneficial, although finding such individuals who can afford the time commitment commanded by BOD membership may prove difficult.

For the board as a whole, it is helpful to maintain a **diversity of views and skills**. In identifying people that can contribute to a board's efficiency, nominators are recommended to go beyond the CV, and look instead for common sense and character in candidates. Technical skills are no longer seen as indispensable for board members, as these can be provided by external consultants. One should also not avoid appointing generalist board members, as their broader view may provide a strategic vision and capacity for synthesis not possessed by more specialized professionals.

When choosing between candidates in possession of the aforementioned skills and experience, intangible qualities like **interpersonal skills, communication skills, diplomacy, leadership** and **courage** must be considered. In small countries like the Baltic states, where the population of suitable board members is limited and business leaders are often personally connected, these qualities can be taken into identified fairly easily. In addition, interviews with potential board members can be carried out in order to appraise the presence of desired characteristics in a candidate.<sup>7</sup>

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<sup>7</sup> OECD Boards of Directors of State-Owned Enterprises - An Overview of National Practices.

## Other Considerations

"In the International Finance Corporation's documentation for good Corporate Governance they demand directors' skills, experience and attributes as follows:

- Financial expertise.
- Industry experience/understanding.
- Legal expertise.
- Representatives of key stakeholders.
- Experience of operating internationally.
- Honesty and Integrity.
- Gender Distribution.
- Age distribution."<sup>8</sup>

The SOE board should consist of a mix of independent directors and representatives of shareholders. Having an all-independent board is neither possible nor feasible for an SOE; independent directors should constitute about half of the board, as this will help bring more professionalism and fresh perspective into the board.<sup>9</sup>

- 3.2 The process should be continuous and proactive, and should take into account the company's agreed strategic priorities. The aim should be to secure a boardroom which achieves the right balance between challenge and teamwork, and fresh input and thinking, while maintaining a cohesive board.

It is often a good idea to include an independent head-hunter or two in the nominating committee, as this ensures the desired level of diversity while selecting people with relevant competences. The nominating committee might even contract an independent and professional executive recruiter for the purpose of short-listing potential board members.<sup>10</sup>

- 3.3 Given the importance of committees in many companies' decision-making structures, it will be important to recruit non-executives with the necessary technical skills and knowledge relating to the committees' subject matter, as well as the potential to assume the role of committee chairman.
- 3.4 Executive directors may be recruited from external sources, but companies should also develop internal talent and capability. Initiatives might include middle management development programmes, facilitating engagement from time to time with non-executive directors, and partnering and mentoring schemes.
- 3.5 Good board appointments do not depend only on the nomination committee. A prospective director should carry out sufficient due diligence to understand the company, appreciate the time commitment involved, and assess the likelihood that he or she will be able to make a positive contribution.
- 3.6 The time commitment required for a productive BOD membership could be anywhere between 10 to 40 hours per month, and more for the chairman of the board. In larger SOEs, directors should be prepared to reserve a whole day for a monthly BOD meeting, as well as schedule some time to introduce themselves to meeting materials provided by the executive board in advance of the meeting.<sup>11</sup>

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<sup>8</sup> Corporate Governance in Swenglish. Global Corporate Governance Forum

<sup>9</sup> Vesperis, Vladislavs (2013). Personal interview.

<sup>10</sup> Loginovs, V. (2013). Personal interview.

<sup>11</sup> Jaunarājs, M., Loginovs, V., Vasks, K. & Rubesa, B. (2013). Personal interviews.

## Four – Evaluating the Performance of the Board and Directors

- 4.1 Boards continually need to monitor and improve their performance. This can be achieved through board evaluation, which provides a powerful and valuable feedback mechanism for improving board effectiveness, maximising strengths and highlighting areas for further development. The evaluation process should aim to be objective and rigorous.
- 4.2 Like introduction and board development, evaluation should be bespoke in its formulation and delivery. The chairman has overall responsibility for the process, and should select an appropriate approach and act on its outcome. The senior independent director should lead the process which evaluates the performance of the chairman. Chairs of board committees should also be responsible for the evaluation of their committees.
- 4.3 The outcome of a board evaluation should be shared with the whole board and feedback, as appropriate, into the board's work on composition, the design of introduction and development programmes, and other relevant areas. It may be useful for a company to have a review loop to consider how effective the board evaluation process has been.
- 4.4 It is considered good practice to carry out externally facilitated board evaluations every three years. External facilitation can add value by introducing a fresh perspective and new ways of thinking. It may also be useful in particular circumstances, such as when there has been a change of chairman, there is a known problem around the board table requiring tactful handling, or there is an external perception that the board is, or has been, ineffective.
- 4.5 Whether facilitated externally or internally, evaluations should explore how effective the board is as a unit, as well as the effectiveness of the contributions made by individual directors. Some areas which may be considered, although they are neither prescriptive nor exhaustive, include:
  - The mix of skills, experience, knowledge and diversity on the board, in the context of the challenges facing the company;
  - Clarity of, and leadership given to, the purpose, direction and values of the company;
  - Succession and development plans;
  - How the board works together as a unit, and the tone set by the chairman and the CEO;
  - Key board relationships, particularly chairman/CEO, chairman/company secretary and executive/non-executive;
  - Effectiveness of individual non-executive and executive directors;
  - Effectiveness of board committees, and how they are connected with the main board;
  - Quality of the general information provided on the company and its performance;
  - Quality of papers and presentations to the board;

- Quality of discussions around individual proposals;
- Process the chairman uses to ensure sufficient debate for major decisions or contentious issues;
- Effectiveness of the secretariat;
- Clarity of the decision processes and authorities;
- Processes for identifying and reviewing risks; and
- How the board communicates with, and listens and responds to, shareholders and other stakeholders.

4.6 OECD Guidelines recommend an annual evaluation to be carried out. It is also recommended the evaluation investigate both how the board is performing overall in addition to the evaluation of individual board members. It should also provide input into “issues such as board size, composition and remuneration of board members.” As already discussed above, these guidelines also support the unique perspective that can be introduced from external and independent experts participating in the evaluation.<sup>12</sup>

## Five – Audit and Remuneration

- 5.1 While the board may make use of committees to assist its consideration of audit, risk and remuneration, it retains responsibility for, and makes the final decisions on, all of these areas. The chairman should ensure that sufficient time is allowed at the board for discussion of these issues.
- 5.2 Sufficient time should be allowed after committee meetings for them to report to the board on the nature and content of discussion, on recommendations, and on actions to be taken. The minutes of committee meetings should be circulated to all board members, unless it would be inappropriate to do so, and to the company secretary (if he or she is not secretary to the committee). The remit of each committee, and the processes of interaction between committees and between each committee and the board, should be reviewed regularly.
- 5.3 For SOE boards, remuneration levels must be set in cooperation with the state. According to OECD practice<sup>13</sup>, pay levels for SOE board members may be set in a centralized fashion - either in line with current market rates, or as a specified amount. Whichever the case, remuneration has to be set at a level sufficient to:
  1. Attract the necessary talent;
  2. Motivate the required level of performance;

In most OECD countries, the former is rarely a problem even if pay is set below private sector rates, although problems may arise in convincing foreign board members to work in the Baltics, when they are used to higher remuneration elsewhere.

Regarding pay as a motivator, evidence shows that directors are just as well motivated by a sense of duty and loyalty to their state and the SOE, as well as by the perceived prestige of being on an SOE board.

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<sup>13</sup> OECD Boards of Directors of State-Owned Enterprises - An Overview of National Practices.

## Six – Relations with Shareholders

- 6.1 Communication of a company's governance presents an opportunity for the company to improve the quality of the dialogue with its shareholders and other stakeholders, generating greater levels of trust and confidence.
- 6.2 The annual report is an important means of communicating with shareholders. It can also be used to provide well thought-out disclosures on the company's governance arrangements and the board evaluation exercise. Thinking about such disclosures can prompt the board to reflect on the quality of its governance, and what actions it might take to improve its structures, processes and systems.
- 6.3 The importance of continual communication with major shareholders, and of the annual general meeting (AGM), should be seen as two aspects of a company's wider communications strategy. The chairman has a key role to play in representing the company to its principal audiences, and is encouraged to report personally about board leadership and effectiveness in the corporate governance statement in the annual report.

## Appendix

### One - Sources of information for preparing for serving on the Board of Directors in a State Owned Enterprise

- OECD Principles of Corporate Governance  
<http://www.oecd.org/daf/ca/corporategovernanceprinciples/31557724.pdf>
- OECD Guidelines on Corporate Governance of State-Owned Enterprise  
<http://www.oecd.org/daf/ca/corporategovernanceofstate-ownedenterprises/34803211.pdf>
- Boards of Directors of State-Owned Enterprises - An Overview of National Practices  
[http://www.keepeek.com/Digital-Asset-Management/oecd/governance/board-of-directors-of-state-owned-enterprises\\_9789264200425-en](http://www.keepeek.com/Digital-Asset-Management/oecd/governance/board-of-directors-of-state-owned-enterprises_9789264200425-en)
- Governance of State-owned Enterprises in the Baltic States  
<http://corporategovernance.lt/uploads/docs/Governance%20of%20State-owned%20Enterprises%20in%20the%20Baltic%20States.pdf>
- Baltic Guidance on the Governance of Government-owned Enterprises  
<http://corporategovernance.lt/uploads/docs/BICG%20Guidance.pdf>



## Two – New Board Member Introduction Programme

Every company should develop its own comprehensive, formal introduction programme that is tailored to the needs of the company and individual non- executive directors. The following guidelines might form the core of an introduction programme.

As a general rule, a combination of selected written information together with presentations and activities such as meetings and site visits will help to give a new appointee a balanced and real-life overview of the company. Care should be taken not to overload the new director with too much information. The new non-executive director should be provided with a list of all the introduction information that is being made available to them so that they may call up items if required before otherwise provided.

The induction process should:

1. Build an understanding of the **nature of the company, its business and the markets in which it operates**. For example, introduction should cover:
  - the company's products or services;
  - group structure / subsidiaries /joint ventures;
  - the company's constitution, board procedures and matters reserved for the board;
  - summary details of the company's principal assets, liabilities, significant contracts and major competitors;
  - the company's major risks and risk management strategy;
  - key performance indicators; and
  - regulatory constraints.
2. Build a link with the **company's people** including;
  - meetings with senior management;
  - visits to company sites other than the headquarters, to learn about production or services and meet employees in an informal setting. It is important, not only for the board to get to know the new non- executive director, but also for the non-executive director to build a profile with employees below board level; and
  - participating in board strategy development. 'Awaydays' enable a new non-executive director to begin to build working relationships away from the formal setting of the boardroom.
3. Build an understanding of the **company's main relationships** including meeting with the auditors and developing a knowledge of in particular:
  - who are the major customers;
  - who are the major suppliers; and
  - who are the major shareholders and what is the shareholder relations policy – participation in meetings with shareholders can help give a first hand feel as well as letting shareholders know who the non-executive directors are.

### The introduction pack

On appointment, or during the weeks immediately following, a new non- executive director should be provided with certain basic information to help ensure their early effective contribution to the company.

## Three – Performance Evaluation Guidance

The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. Individual evaluation should aim to show whether each director continues to contribute effectively and to demonstrate commitment to the role (including commitment of time for board and committee meetings and any other duties). The chairman should act on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the board and, where appropriate, proposing new members be appointed to the board or seeking the resignation of directors. The board should state in the annual report how such performance evaluation has been conducted.

It is the responsibility of the chairman to select an effective process and to act on its outcome. The use of an external third party to conduct the evaluation will bring objectivity to the process.

The non-executive directors, led by the senior independent director, should be responsible for performance evaluation of the chairman, taking into account the views of executive directors.

The evaluation process will be used constructively as a mechanism to improve board effectiveness, maximise strengths and de-risk weaknesses. The results of board evaluation should be shared with the board as a whole while the results of individual assessments should remain confidential between the chairman and the non-executive director concerned.

The following are some of the questions that should be considered in a performance evaluation. They are, however, by no means definitive or exhaustive and companies will wish to tailor the questions to suit their own needs and circumstances.

The responses to these questions and others should enable boards to assess how they are performing and to identify how certain elements of their performance areas might be improved.

### Performance evaluation of the board

- How well has the board performed against any performance objectives that have been set?
- What has been the board's contribution to the testing and development of strategy?
- What has been the board's contribution to ensuring robust and effective risk management?
- Is the composition of the board and its committees appropriate, with the right mix of knowledge and skills to maximise performance in the light of future strategy? Are inside and outside the board relationships working effectively?
- How has the board responded to any problems or crises that have emerged and could or should these have been foreseen?
- Are the matters specifically reserved for the board the right ones?
- How well does the board communicate with the management team, company employees and others? How effectively does it use mechanisms such as the AGM and the annual report?
- Is the board as a whole up to date with latest developments in the regulatory environment and the market?
- How effective are the board's committees? [Specific questions on the performance of each committee should be included such as, for example, their role, their composition and their interaction with the board.]

The processes that help underpin the board's effectiveness should also be evaluated e.g.:

- Is appropriate, timely information of the right length and quality provided to the board and is management responsive to requests for clarification or amplification? Does the board provide helpful feedback to management on its requirements?
- Are sufficient board and committee meetings of appropriate length held to enable proper consideration of issues? Is time used effectively?
- Are board procedures conducive to effective performance and flexible enough to deal with all eventualities?

In addition, there are some specific issues relating to the chairman which should be included as part of an evaluation of the board's performance e.g.:

- Is the chairman demonstrating effective leadership of the board?
- Are relationships and communications with shareholders well managed?
- Are relationships and communications within the board constructive?
- Are the processes for setting the agenda working? Do they enable board members to raise issues and concerns?
- Is the company secretary being used appropriately and to maximum value?

## **Performance evaluation of the non-executive director**

The chairman and other board members should consider the following issues and the individual concerned should also be asked to assess themselves. For each non-executive director:

- How well prepared and informed are they for board meetings and is their meeting attendance satisfactory?
- Do they demonstrate a willingness to devote time and effort to understand the company and its business and a readiness to participate in events outside the boardroom such as site visits?
- What has been the quality and value of their contributions at board meetings?
- What has been their contribution to development of strategy and to risk management?
- How successfully have they brought their knowledge and experience to bear in the consideration of strategy?
- How effectively have they probed to test information and assumptions? Where necessary, how resolute are they in maintaining their own views and resisting pressure from others?
- How effectively and proactively have they followed up their areas of concern?
- How effective and successful are their relationships with fellow board members, the company secretary and senior management? Does their performance and behaviour engender mutual trust and respect within the board?
- How actively and successfully do they refresh their knowledge and skills and are they up to date with:
  - the latest developments in areas such as corporate governance framework and financial reporting?
  - the industry and market conditions?
- How well do they communicate with fellow board members, senior management and others, for example shareholders? Are they able to present their views convincingly yet diplomatically and do they listen and take on board the views of others?

## Four – Pre-Appointment Due Diligence Checklist for New Board Members

### WHY?

Before accepting an appointment a prospective non-executive director should undertake their own thorough examination of the company to satisfy themselves that it is an organisation in which they can have faith and in which they will be well suited to working.

The following questions are not intended to be exhaustive, but are intended to be a helpful basis of the pre-appointment due diligence process that all non- executive directors should undertake.

### Questions to ask

What is the company's current financial position and what has its financial track record been over the last three years?

What are the key dependencies (e.g. regulatory approvals, key licences, etc)? What record does the company have on corporate governance issues?

If the company is not performing particularly well is there potential to turn it round and do I have the time, desire and capability to make a positive impact?

What are the exact nature and extent of the company's business activities?

Who are the current executive and non-executive directors, what is their background and their record and how long have they served on the board?

What is the size and structure of the board and board committees and what are the relationships between the chairman and the board, the chief executive and the management team?

Who owns the company i.e. who are the company's main shareholders and how has the profile changed over recent years? What is the company's attitude towards, and relationship with, its shareholders?

Is any material litigation presently being undertaken or threatened, either by the company or against it?

Is the company clear and specific about the qualities, knowledge, skills and experience that it needs to complement the existing board?

What insurance cover is available to directors and what is the company's policy on indemnifying directors?

Do I have the necessary knowledge, skills, experience and time to make a positive contribution to the board of this company?

How closely do I match the job specification and how well will I fulfil the board's expectations?

Is there anything about the nature and extent of the company's business activities that would cause me concern both in terms of risk and any personal ethical considerations?

Am I satisfied that the internal regulation of the company is sound and that I can operate effectively within its stated corporate governance framework?

Am I satisfied that the size, structure and make-up of the board will enable me to make an effective contribution?

Would accepting the non-executive directorship put me in a position of having a conflict of interest?

### **Sources of information**

- Company report and accounts for the recent years.
- Analyst reports.
- Press reports
- Company web site
- Any Corporate Social Responsibility or Environmental Report issued by the company.
- Rating agency reports
- Published material is unlikely to reveal wrong-doing, however a lack of transparency may be a reason to proceed with caution.



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[www.corporategovernance.lv](http://www.corporategovernance.lv)

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