THE IMPACT OF CORPORATE GOVERNANCE IN THE QUALITY OF MANAGEMENT
An approach to the evaluation of a Board of Directors

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SUMMARY

Corporate Governance is presently being recognized as a key factor in the long-term success of Companies around the world. Good Governance implies the need to establish and operate within a framework of accepted core values. In this sense, best practices have been established in various International projects (Ref: 2, 4 and 5). We have developed a system through which a Board of Directors can be evaluated and its performance measured against these best practices. We use a matrix where key attributes are evaluated and the results are expressed in a simple, numerical way. The evaluation process not only provides the status of Governance at a certain moment in time but also serves as the basis of information for the necessary improvement plans. The process we propose also constitutes an excellent feedback mechanism as the plans are implemented and measured. The matrix, being a graphical and clear representation of the board situation, also represents an excellent management communication tool.

In this paper we describe the key elements used in the construction of the matrix, as well as of its numerical evaluation process.

Criteria for Board Evaluation

Criteria purposes

The Criteria are the basis for Board evaluation and self assessment to help improve performance practices, capabilities and results.

Core values and Concepts:

The Criteria are built upon the following set of interrelated Core values and Concepts

Leadership

The Board should set directions with high expectations and clear and visible values, aligning the interests of all stakeholders, to support and guide the decision making of all members of the organization.

Independence. Board independence from management is crucial to ensure that the Board effectively carries out its mission and responsibilities and fairly holds management accountable to shareholders.

Ethics & Transparency. Board should ensure ethical behavior and compliance with laws and regulations, auditing and accounting principles.

Difference between Governance and Management

The effectiveness of Boards is reduced by the failure of their members to think through and understand the distinction between governance and management. The main function of the Board is to effectively do:

-the strategic guidance of the company and

- monitoring management.

Directors and Managers roles must be defined assuring that implementation is clearly a Management responsibility

Focus on well documented processes that add value.

Corporate Governance must be good for the company business by creating value for all stakeholders. This should be the guidance for selection of the Board Best Practices.

All items in this Board Evaluation Approach require formal written processes, transparent and well documented.

Focus on results

Not on procedures, tools or organizational structure.

For the evaluation of a Board of Directors, seven Criteria Categories were established each one of them subdivided into items:

1. Mission and Principles
2. Board structure
3. Board operating procedures
4. Board & Management
5. Board & shareholders
6. Board & community
7. Board Contributions

1. Mission and Principles

This is a key area of Corporate Governance where the Values and the Mission of the Company are established, aligned thorough it, and enforced in its implementation.-

The basic Board Mission should be to ensure the strategic guidance of the company and the effective monitoring of management.

In this sense the following areas are covered:

1.2. Legal framework – Liabilities

1.3. Code of Corporate Governance Best Practices

2. Board Structure

The composition of the Board varies depending on the needs of the Company. It is not possible to formulate or design a model Board that would represent the best solution for even a small proportion of companies.

In this sense the following areas are covered:

2.1. Board size

2.2. Chairman (Separation of Chairman and CEO- Lead Director)

2.3 Mix of inside and external independent Directors

2.4.Board committees

3. Board Operating Procedures

Related to the BOD internal operating structure, the following areas are covered:

3.1. How to select new members

3.2 Definition of independence

3.3. Directors function description

3.4. Training and orienting directors

3.5. Meetings, agenda, minutes and follow up

3.6. Election term/ Term limits/ Mandatory retirement

3.7. Board compensation review
3.8. Participation of Senior Managers and other non directors in meetings

3.9. Board and Directors assessment. Self assessment.
The Board should have an effective process for assessing its own performance.

4. Board and Management

Another key area related to the Board contribution to the Company. A clear distinction Board and Management function is mandatory and belongs to this area, covering subjects like:

4.1. Formal evaluation of CEO
4.2. Senior management's compensation
4.3. Board access to senior management
4.4. CEO succession planning
4.5. Company information
4.6. Risk assessment and risk management.
4.7. Clear definition of the Board and top management roles

5. Board and Shareholders

The board responsibilities related to its accountability to Shareholders Are presented here, through areas such as:

5.1 Content and character of disclosure
5.2 Compliance with basic shareholders rights

6. Board and Community

Disclosure to government and community should comply with the law and regulations and its spirit. In this area we can observe:

6.1. Disclosure to Government and Community.
6.2. Company Communications to Institutional Investors, Customers, and to the Press.
6.3. Company actions related to Community issues

7. Board Contribution

In the end, all board activities should proactively contribute to the Company results. In this sense we recognize areas such as:

7.1 On company results
7.2 On Company competitive access to Capital
7.3 On generating value
7.4 On Stakeholders perception of the Board contribution

General guidelines to assign scores

Recommend to follow the methodology indicated in the Criteria for Performance Excellence published by the Baldridge National Quality Program. Many countries in the world have National Quality Awards with similar criteria to the Baldridge Award in the U.S.A. each one in its own language. It is also highly recommended for Directors to be literate on how companies are evaluated for Quality Awards.

A procedure to evaluate the performance of a Board of Directors should be based on a comparison against a target model that represents the state of the art, as it is usually done in quality award programs. In this work we use the OECD Principles for Corporate Governance as the target model [2]. In this way a matrix can be constructed with seven columns (criteria) and four rows (levels).

The seven criteria have been already described (page2), and the four levels are:

-Level 1: Understanding the need to improve Corporate Governance

-Level 2: First concrete steps toward establishing best practices
-Level 3: Implementation of best practices
-Level 4: Leadership

The use of this procedure is straightforward: for each of the seven columns, the cell that best represents the current situation of the Company is chosen. Each cell has a score range, as to accommodate for different Company status within each cell. The resulting matrix represents the performance of the Board of Directors and can help companies to perform its Board evaluation.

The Matrix

The evaluation matrix is composed of seven columns, the criteria categories, and four levels as described above. The levels considered in each category can be used as a way to build a continuum which helps the company progress toward Excellence in the Board of Directors. In order to work with actionable results a certain **score** must be assigned to each level as well as a **factor** for each category, for a total maximum score of, say, 1000.

Once a certain score is developed for a Company, Country or Region a matrix similar to that of Figure 1 is obtained, which contains a certain range of values for each level and a factor for each category.

The system should be dynamic, dependent on time and geography and the scores and factors in the system must be updated on a timely basis accordingly to the Company, Country or Region progress.

A model of the matrix is shown, with a selection of scores and factors as an example:

BOARD EVALUATION MATRIX

LEVEL	SCORE	Mission & Principles	Structure	Board Oper. Procedures	Board & MGMT	Board & Shareholders	Board & Community	Board Contribution	Total Evaluation
1	0-1								
2	>1 to 3								
3	>3 to 7								
4	>7 to 10								
Score		0	0	0	0	0	0	0	
Factor		20	7	7	10	10	6	40	
Total		0	0	0	0	0	0	0	0

Figure 1

CONTENTS OF THE MATRIX CELLS

Each matrix cell contains a description of possible attributes of Corporate Governance, related to each level.- The cell that best represents the status of the BOD must be selected, for each of the seven criteria. Once this is done, the procedure assigns a certain score for each cell which, when affected by the Criteria factor, provides a total score for the company's BOD. In this way a clear, numerical evaluation of the BOD is obtained not only as a total number, but as a relative score for each criterion as well.-

CONCLUSIONS:

The evaluation of the BOD is a key strategic decision of the Enterprise that will, over time, improve the Board's contribution to the Company. This allows the Directors to have a reference to be compared with. An improved Governance level will, in turn, improve the performance of the Company and shareholder value on the long term. The proposed evaluation process constitutes the basis for the development of BOD improvement plans, with the matrix as a clear information tool which can help establish targets for each criterion. Once implemented, the matrix will also help measuring the progress against those goals both as a total result as well as partially for each criterion. The score and the factors can be professionally selected accordingly to the board development status, geography, and time. We believe that this procedure can help to improve Corporate Governance at the Company, Region, and Country level in a complete, yet simple way.

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