QUOTED COMPANIES ALLIANCE

Henley Business School
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Research Report

Board Performance Review in Small and Mid-Sized Quoted Companies

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Contents

The Quoted Companies Alliance is the independent membership organisation that champions the interests of small and mid-sized quoted companies. It is a company limited by guarantee registered in England under number 4025281.

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This report identifies how most smaller companies' boards can be characterised as either inactive, reactive or proactive with regards to board performance review and it provides a valuable snapshot as to how growth companies differ from larger companies in this area.

QCA and Downing LLP

Board performance reviews are an important element of corporate governance. At the Quoted Companies Alliance (QCA) and Downing LLP, we know from everyday conversations that many growth companies struggle with where to start with evaluating their board, whilst others wrestle with whether external assessment would be necessary or helpful.

We therefore wanted to better understand how small and mid-sized quoted companies were going about board performance reviews, how this differed between companies of different size and stage of development, and what can be learned as good practice to be shared with QCA members and the UK small and mid-cap ecosystem.

We therefore commissioned Henley Business School to conduct comprehensive quantitative and qualitative research to understand the lay of the land for small and mid-caps in this area. This research is presented in this report. It identifies how most smaller companies' boards can be characterised as either inactive, reactive or proactive with regards to board performance review and it provides a valuable snapshot as to how growth companies differ from larger companies in this area. Companies will benefit from reviewing where they sit on this spectrum and assessing if there are improved practices they can learn from other companies at a similar stage of development to them.

To accompany this report, we have produced a separate practical guide to board performance reviews.[1] It takes the findings of this research and distils six recommendations for companies to follow as good practice for such reviews.

We hope that this research and the corresponding guidance will help companies as part of their ongoing process to improve the performance of their boards and, ultimately, help their businesses grow.

Tim Ward
Chief Executive, QCA

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Partner, Downing LLP

[1] QCA, 2021, **The QCA Board Performance Review Guide** bit.ly/3bKcOGn

Introduction from Henley Business School

It is often said, and directors like to agree, that the board is the ultimate decision-making body of the enterprise, charged with the responsibility of ensuring the organisation's long-term sustainability. Boards are required to 'lead by example' and to 'set the tone' for how company management and the wider workforce should go about their work in the business. It is for the board to ensure that the organisation is performing at its best and observing high ethical and moral standards.

And yet, when it comes to board performance review, many boards struggle in getting to grips with their responsibilities. If the board is the ultimate decision-making body, then it goes without saying that it should subject itself to rigorous evaluation. How can boards ask their managers and employees to submit themselves to performance scrutiny if the directors themselves are exempt from such assessment? So much for leading by example and setting the tone. Board performance assessment is simply a matter of good business practice and good sense. Directors do not arrive on the board as a 'finished article'; on the contrary, theirs is a difficult job requiring reflection, development and continuous improvement.

Principle 7 of the QCA Corporate Governance Code requires companies to 'evaluate board performance based on clear and relevant objectives, seeking continuous improvement'. Nonetheless, many boards pay only lip service to this principle or else do no board performance review at all. This is a cause for concern: it offers little confidence to investors and wider stakeholders.

In response to this, the QCA and Henley Business School have joined forces to investigate the reality of the board performance review in small and mid-sized quoted companies, to gain insights and to offer guidance that could be useful in moving the practice forward.

This report captures the results of these efforts. It contains analysis and discussion of 30 interviews with companies and investors about board performance reviews and 100 survey responses from companies. It presents a detailed discussion of insights into how companies are currently approaching board performance reviews in terms of frequency, type, accountability, engagement, topics, methods, outcomes, continuous improvement and disclosure.

Henley Business School would like to thank the QCA and Downing LLP for the support they have provided towards this study, and all of the interviewees and survey respondents who so generously gave up their time for this research.

Henley Business School

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Executive summary

This new and unique research, conducted by Henley Business School for the QCA and Downing LLP, is based on 30 in-depth interviews with board members and investors, along with 100 survey responses from small and mid-sized quoted companies. The key findings are summarised as follows:

1. Of the 100 companies that completed the survey, 22 had no formal board performance review. We call these boards '**inactive boards**'.
2. Acknowledging the fact that some companies conduct no formal board performance review, **this research recognises the value of informality**. While in some cases an informal approach is perceived as working effectively, **this is not the best way forward as the company grows**.
3. The remaining boards surveyed are classified as either 'reactive boards' or 'proactive boards'. Proactive boards are those that: i) undergo regular formal board performance reviews; ii) make the reviews' objectives explicit from the outset; iii) proactively follow up from previous evaluations; iv) are effective in applying recommendations from the reviews; v) change the objectives of their board performance reviews in response to arising actions. Reactive boards are those that fail to meet one or more of these conditions.
4. **Of the 78 companies that conduct board performance reviews, a majority (56 boards) tend to approach board performance reviews reactively; the remaining 22 are proactive in their approach.**
5. Proactive boards tend to be larger companies (81% of proactive boards preside over companies of over 250 employees); conversely, inactive boards – those that do no formal review – tend to be from smaller companies (65% of inactive boards preside over companies with fewer than 250 employees).
6. Those companies that do not carry out formal board performance reviews cite **budget** and a **perception of low value** as the key reasons for the omission.
7. In 81% of companies that conduct formal board performance reviews, the **Chair is seen as the individual ultimately accountable for their effectiveness** (77% in proactive boards and 82% in reactive boards).
8. The **Company Secretary is most likely to drive the process of board performance review** (53%), followed by the Chair (44%) and then the "board as a whole" (12%).
9. Overall, **the engagement levels of the different boardroom roles are far from ideal**, with boards taking reactive approaches also exhibiting lower engagement scores in both smaller companies (only 67% high to very high engagement) and in larger companies (57% high to very high engagement).
10. Customised structured questionnaires (72%) and one-to-one discussions/interviews (67%) are the most common methods used for board performance review. Only 13% of companies admit seeking feedback from internal stakeholders (e.g. general management); even fewer (10%) admit seeking feedback from external stakeholders (e.g. customers and suppliers). **A board evaluation should not be just an inward-looking exercise.**
11. The Senior Independent Director (SID) (36%) and the "board as whole" (35%) are the two main sources of Chair performance evaluation, far exceeding other sources. However, 15% admit that "no one evaluates the Chair performance" or else "don't know" (3%). **Investors see Chair performance evaluation as critical.**

12. There is a much more comprehensive coverage of board performance topics in proactive boards in comparison to reactive boards. **The least evaluated topics are:** ESG performance, performance and engagement of individual members, professional development needs of board members, and succession planning (executive and non-executive).

13. **The outcomes of a board performance review** are most typically presented internally in the form of "detailed formal feedback to the board as a whole" (50%) or the "Chair presents a collated summary" (44%). It is less common to find the development of action plans for the board as a whole (32%), recommendations on how to improve processes/reporting (32%), or action plans for each individual member of the board (15%).

14. **Both proactive and reactive boards highlight the same top areas of tangible benefit from board performance reviews:** improved board performance as a whole (86% and 69% respectively), improved individual performance of board members (68% and 56%), and improved governance (68% and 58%). Proactive boards report more benefit from strategy and competitive advantage (27% versus 16%), value creation (32% versus 15%), improved sustainability (23% versus 11%) and added stakeholder value (32% versus 16%).

15. Over 60% of reactive boards are average or below average in applying the recommendations from a board performance review. Proactive boards rate themselves as exclusively either good or excellent in this regard.

16. In terms of the **disclosure of the results of a board performance review**, 56% of surveyed companies present a summary of the key points/themes in their annual report whereas only 1.3% present the results in detail. Some 39% do not present any board performance review and 4% don't know.

17. In conclusion:

    - Board performance reviews can unlock significant value, prevent value destruction, and improve relationships and the reputation of the board both within the board itself and with investors and other stakeholders.
    - Proactive boards are those that approach board performance reviews in a dynamic fashion with a focus on continuous improvement; they are also those that report the greatest tangible benefits.
    - **There is still a lot of room for improvement in board performance review practice in small and mid-sized quoted companies.**

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1. Board performance reviews in large, mid-sized and small quoted companies

Board performance and effectiveness is more important than ever, and this is not solely as a result of the 2008 global financial crisis and the much-publicised corporate scandals of Enron, Carillion, Wirecard and so on.

The broadening role of the board now encompasses: board dynamics and processes; composition and diversity; strategy and business; and monitoring and risk management. It is also acknowledged that a well-functioning board contributes to a company's competitive advantage.[2] Stakeholder expectations are higher than they have ever been, so boards find themselves under spotlights coming from many directions and perspectives. It has been shown that 60% of board members feel adequate processes are in place to evaluate performance[3] – but is 'adequate" enough for key stakeholders, such as customers, employees, investors and shareholders? Is board performance review a truly integrated and embedded element of board performance or an annual compliance exercise? There appear to be differences in how large and smaller companies approach board performance review, each approach having its pros and cons. An informal approach by a smaller company brings its own benefits in terms of learning – meaning there is value in informality.

> *"I do an informal evaluation, not a formal one, but my own view is it doesn't have a major benefit unless it's done by independent outside consultants."* Chair

> *"Now as we grow up, we are gradually instituting more of that formality. It's not that we're ignoring the issue but in a very small team you tend to manage it in a more informal fashion."* CEO

Board performance review was first mentioned in general effectiveness terms in the Cadbury Report (1992), described therein as a motivation – "what is needed is the will to improve its [the board's] effectiveness". This applies to all listed companies. Fast-forward to the recent update to the UK Corporate Governance Code,[4] and board performance review is now found to be prescriptive. The Code stipulates that an annual evaluation should be conducted – and for FTSE 350 companies an external board performance review every three years. With regard to disclosure – in the annual report or on the company website – the external evaluator should be identified along with a declaration of the supplier's independence or its connection with anyone in the company or on the board.

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[2] OECD (2018). **Board Performance Review: Overview of International Practices** bit.ly/3enJS7y
[3] Grant Thornton (2017). **The Board: Creating and Protecting Value** bit.ly/3voHK6J
[4] FRC (2018). **The UK Corporate Governance Code** bit.ly/32PkjXT

More comprehensive recommendations have recently been proposed in a review of the effectiveness of external evaluators carried out by the Chartered Governance Institute.[5] Disclosure should encompass how the board performance review has been conducted, the exact nature of the evaluation contact with board members, the outcomes and actions taken, and how the evaluation influences board composition. The 2018 Code is inclusive and precise: it demands a "formal and rigorous evaluation of the performance of the board, its committees, the chair and individual directors".

Larger companies have board directors and executive directors with more formal and distinct role separation and greater support from company secretaries and other professional suppliers or consultants. These companies have larger boards and larger executive teams with more readily available resources. Independence is explicit and decision-making is more complex. The Wates Corporate Governance Principles for Large Private Companies[6] is relatively light on board performance review, but emphasises regular evaluation, which aids individual director contribution and "highlights the strengths and weaknesses of the board". The Chair is made accountable for acting on the recommendations.

The QCA Corporate Governance Code (the QCA Code) was compiled for smaller companies and especially those quoted on growth markets (such as AIM and AQSE), acknowledging these companies' reduced resources and arguably greater focus on cash flow and growth. While there is no formal definition of a growth company, these businesses make growth their main strategy and focus. These businesses often lack established governance, and pursue market finance and investor recommendations to enable their growth. These businesses are typically more volatile, with founder-owners and private investors as part of the board. The QCA Code stipulates regular board performance reviews, with website disclosure on: how often such a review takes place; explicit links between board performance review, succession planning and senior management appointments; where it took place; the process and its evolution; performance criteria; results and recommendations; progress against actions; and the Senior Independent Director (SID)'s responsibility for evaluating the board Chair.

[5] ICSA – The Chartered Governance Institute (January 2021). **Review of the Effectiveness of Independent Board Evaluation in the UK Listed Sector** bit.ly/3dPskCz

[6] FRC (2018). **The Wates Corporate Governance Principles for Large Private Companies** bit.ly/3wmmAqb

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2. Approaches to board performance review: proactive, reactive and inactive boards

Our research found different mindsets with regard to board performance review, and these impact the company's approach. We have categorised the boards as proactive, reactive or inactive, based on their responses to key questions.

Firstly, inactive boards were defined as those that answered "no" in response to the first question: did they conduct a "regular, formal evaluation"? Investors have a clear expectation that a board performance review and learning should take place, so the worst-case scenario for investors is inactivity, i.e. no evidence of any formal board performance review.

We grouped positive responses from five key survey questions to create a profile for the 'proactive board'. Those respondents who answered in the negative to these questions were labelled 'reactive boards'. So: a positive response to all of the following = proactive board; negative responses to questions 2–5 = reactive board; and a negative response to question 1 = inactive board. In question 4, a response of either "good" or "excellent" scored a 'proactive' rating. The questions were:

1. Does the board undergo a regular formal evaluation process?
2. Are the objectives of the board performance review made explicit from the outset?
3. Is there proactive follow-up from a previous evaluation?
4. How effective is the board at applying the recommendations from an evaluation?
5. As a result of the arising actions, do objectives continuously change for subsequent evaluations?

Of the 78 companies conducting board performance reviews, a significant number (56) have boards that tend to approach their performance reviews reactively, with the other 22 of those 78 being proactive in their approach. The remainder (22 companies) were inactive.

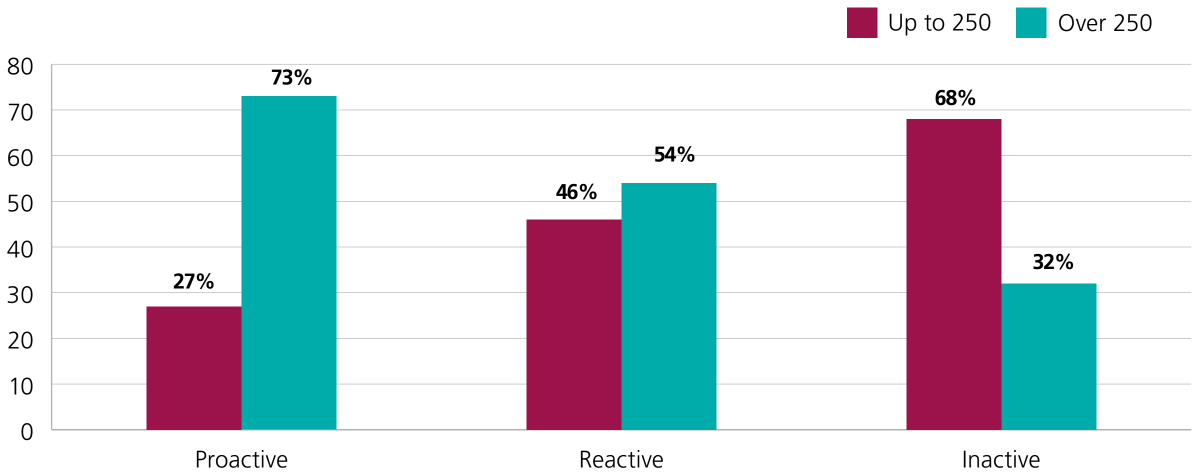
2.1 Does company size matter?

So, does size matter? Our sample comprised approximately an equal amount of small and larger companies (46.5% were smaller businesses with up to 250 employees, and 53.5% larger companies with over 250 employees).

'Proactive' boards tend to belong to larger companies (81% of proactive boards preside over more than 250 employees), whereas 'inactive' boards that do no formal review tend to be from smaller companies (65% of inactive boards are from companies with fewer than 250 employees).

Our analysis of board type by size of company shows that 68.2% of smaller companies and 31.8% of larger companies are inactive. Of the proactive boards, larger companies (72.7%) lead the way compared to small companies (27.3%) (Figure 1). Surprisingly, there are almost equal numbers of reactive boards among small and larger companies. Comparing these survey results with the qualitative feedback from interviews with small and mid-sized quoted companies, we notice a perception of how formality or informality contribute to a good board performance review. It seems that, for the larger company, formality is perceived as important, but for smaller companies less formality is pragmatic good practice.

Figure 1: Proactive, reactive and inactive boards by size



However, informality and inactivity are not the same thing, which is why we created the categories of proactive and reactive boards. Informality on boards of smaller and growth market quoted companies can be a positive attribute, when engagement, process and methods are relatively informal but a review and evaluation still takes place. It may be argued that regulation is driving the demand for formal and external board performance reviews, whereas investors are pragmatic and wish to see incremental improvement to board effectiveness and good governance. Recent consultations[7] on board effectiveness suggest that external board performance review providers would benefit from explicit 'regulation', although it is doubtful whether this would erase the cynicism around external evaluations. Perhaps a more constructive approach is to consider how a good informal evaluation could be conducted and disclosed.

[7] Deloitte (2019). **Board Effectiveness Consultation** bit.ly/3dQA1Il

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3. Frequency and type of board performance reviews

Internal board performance reviews are overwhelmingly the most popular approach for small and mid-sized quoted companies, as rated by board directors and investors.

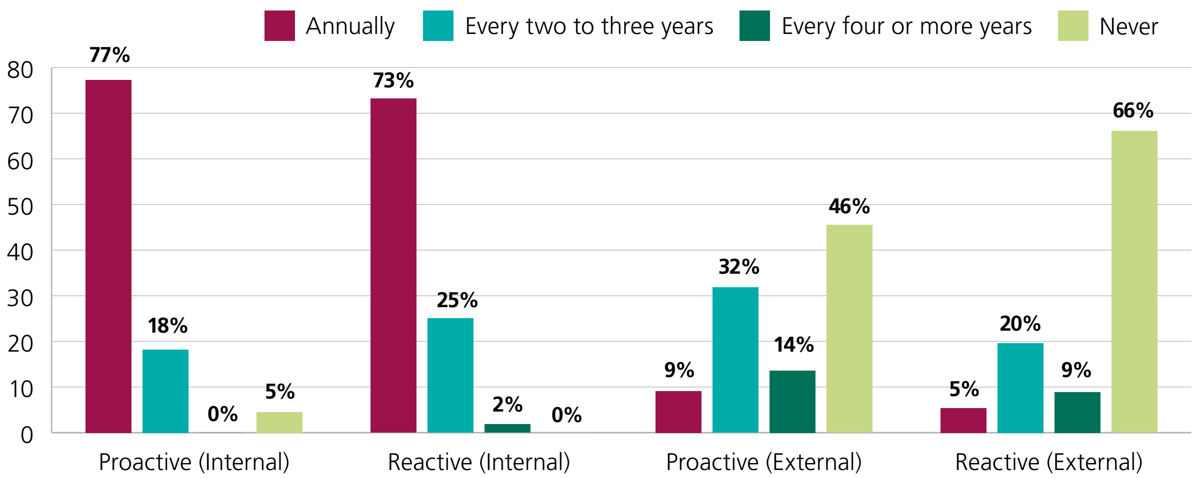
Budget and perceived absence of value were the main reasons our interviewees gave for not doing a board performance review, despite its attested promise of value-added. A further reason given is that any governance or interpersonal issue on the board is addressed on an ad hoc basis at the time it arises. It was acknowledged that some internal evaluations are informal but undertaken with a view to them becoming more structured over time, although it is unclear what exactly might trigger this move to a more formal approach. A general board discussion and several 'backstage' conversations (i.e. outside of the boardroom) may help resolve issues but this is not a formal evaluation.

> *"I think if we went down the external evaluation route, that would make it a much more formal and political process."* CFO

> *"I think a real board performance review has to be internal because that's where you get real and meaningful."* Chair

Approximately three-quarters of both proactive (77.3%) and reactive (73.2%) boards participate in internal board performance reviews on an annual basis (**Figure 2**). We suggest that these 'formal' board performance reviews may look very different in terms of process, methods and quality of output. There are no external evaluations taking place in some proactive boards (45.5%) and the majority of reactive boards (66.1%). About a third (31.8%) of proactive boards conduct an external evaluation every 2–3 years, compared to 19.6% of reactive boards.

Figure 2: How often is a formal board performance review undertaken either internally or externally?



The main objections given by small and mid-sized quoted companies to external evaluations are time, cost, lack of in-depth knowledge about the business and the consultant heavily cross-selling other products or their organisation. There is also a level of cynicism whereby the external evaluator is perceived as being obliged to find issues to remedy in order to justify their fee. Among those small and mid-sized quoted companies that do have experience of external evaluation, we noted surprise being expressed at the significant improvements that can be made: the external route can act as a catalyst, they found, to crystallise issues for action. Increased candour is another valuable outcome of external evaluations. Some small and mid-sized quoted companies do not see external evaluation as relevant for their businesses and do not envisage it happening in the future. It is seen as too formal and potentially politically disruptive – more about corporate measures rather than individual feedback. A commitment to an external board performance review is seen by interviewees as a decision for the Chair.

> *"The external person has got to find something in order to justify their fees."* NED

> *"I think it [external evaluation] was about doing proper governance and making sure that the board is being as effective as we can be."* NED

Investors confirm that, for verification of good practice, an internal evaluation once every three years is acceptable, ideally also with external evaluation. However, they acknowledge that levels of awareness and evidence of good practice are highly variable aspects of small and mid-sized quoted companies. Allowing for the fact that these companies are on a journey, the frequent perception that board performance review is a compliance exercise feeds the wrong mentality and expectations among board members. Internal board performance reviews are seen as a more legitimate, value-add practice, whereas an external assessor will need to gain an understanding of the highly contextual issues and tensions of the board. It is argued that external assessors are not equipped with detailed business and board-specific knowledge. Investors claim that the smaller and more familiar the board, the greater the need to carry out a board performance review. Even internal reviews should, if possible, have a level of independence from the board members. Self-reflection and output, or actions, are the two most important aspects of board performance review, according to investors.

> *"There was a sense of he'd [external evaluator] got his claws into us and was never going to let go; there was always some more to do, always another workshop to have. There were lots of things being produced, but it didn't seem to be coming to a proper conclusion."* NED

> *"You could argue it shouldn't be necessary for a company to spend tens of thousands of pounds for someone to come and tell the board what they know already but I think that's possibly sometimes the case."* Company Secretary

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4. Accountability and engagement

4.1 Accountability for board performance review

Board performance review can be driven by different motivations depending on the type of board performance improvement being sought. It is an opportunity for the board to discuss both board culture and company culture, and how they are helping or hindering the achievement of strategy and impacting teamwork. A top priority is the need to ascertain whether the board has the skills that the strategic plan demands, and this often drives the evaluation. Another driver is a consideration of how much time the board spends discussing strategy relative to how much on governance. However, relatively little strategic thinking is in evidence about how the evaluation can be used as a marketing tool, either with internal or external stakeholder groups.

For those 81% of companies that conduct formal board performance reviews, the Chair is generally seen as the individual who is ultimately accountable for their effectiveness. Further, as we would expect (**Table 1**), the Chair is seen as the most accountable person by the majority of respondents on both reactive and proactive boards, although this perception is stronger on reactive boards (82.1% versus 77.3%). The Company Secretary (27.3%), CEO (18.2%) and Governance Committee (13.6%) are more likely to be ascribed accountability on proactive boards. The reactive board tends to both dilute and spread accountability, with the board as a whole (21.4%), the Nomination Committee (16.1%) and the Remuneration Committee (10.7%) all seen as being more accountable in this category.

Table 1: Who is accountable for ensuring board performance review takes place?

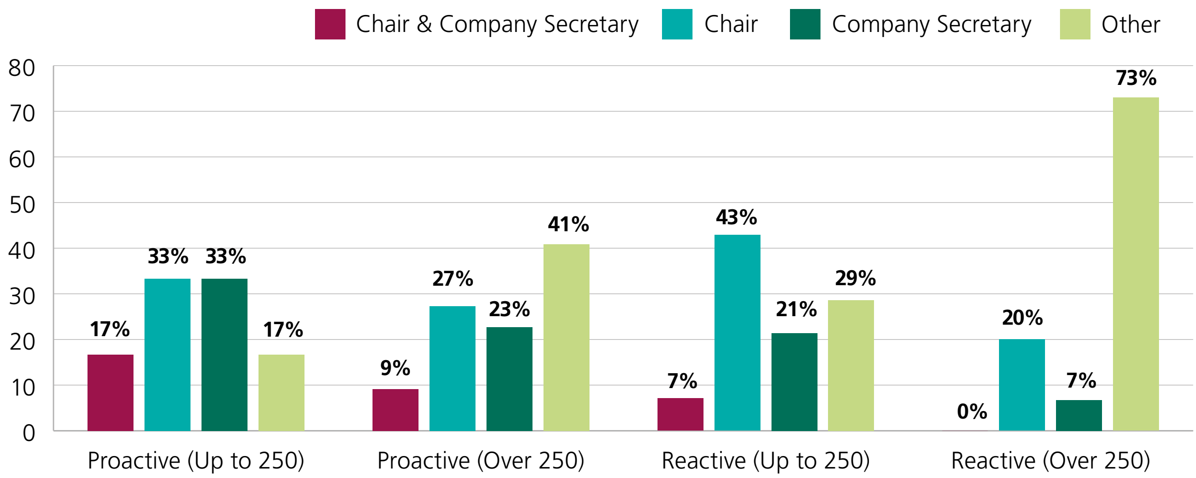
Who is accountable?	Proactive boards (%)	Reactive boards (%)
Chair	77.3	82.1
CEO	18.2	14.3
Senior Independent Director	4.5	17.9
Board as a whole	18.0	21.4
Company Secretary	27.3	12.5
Governance Committee	13.6	7.1
Nomination Committee	0.0	16.1
Remuneration Committee	4.5	10.7
Risk Committee	4.5	3.6

Note: multiple responses possible

We differentiate between who is accountable for board performance review and who drives it (**Figure 3**). Overall, the Company Secretary drives the process of board performance review most often (53%), followed by the Chair (44%) and then the 'board as a whole' (12%).

Applying our overlay of proactive and reactive boards, we see that a combination of Chair and Company Secretary is rated equally on both proactive and reactive boards, at 66.7%. However, the part these key roles play in driving board performance review is notably more significant in proactive boards of large companies in comparison to proactive boards of smaller companies. The "other" responses in Figure 3 refer to the CFO, the executive team or a sub-committee. The Company Secretary appears to be less likely to drive board performance review in smaller companies but more so on reactive boards. The results suggest that Chairs of smaller companies with both proactive and reactive boards could do more to drive board performance review.

Figure 3: Who drives the board performance review internally?



Note: 'Other' can include the CEO, the Senior Independent Director, the board as a whole or a specific committee.

A key driver of board performance review for small and mid-sized quoted companies is regulation and compliance, albeit with the recognition that it can also be a catalyst for change. At the same time, a general view is that boards should not wait for an annual evaluation to address board issues. This attitude is exemplified by the assertion by our interviewees that constant dialogue with non-executive directors (NEDs) avoids the need for a formal annual exercise. Investors seek a strong lead, and whoever facilitates the evaluation should have gravitas, emotional intelligence and respect for confidentiality. The role and contribution of the Chair is critical; a negative attitude towards board performance review from the Chair is a self-fulfilling prophecy that leads to low-value outcomes and disengaged board members. Involvement by board committees is marginal, despite Nomination Committees often having board performance review and effectiveness as part of their remit.

> *"No evaluation will be effective unless the Chair wants it to be that way."* NED

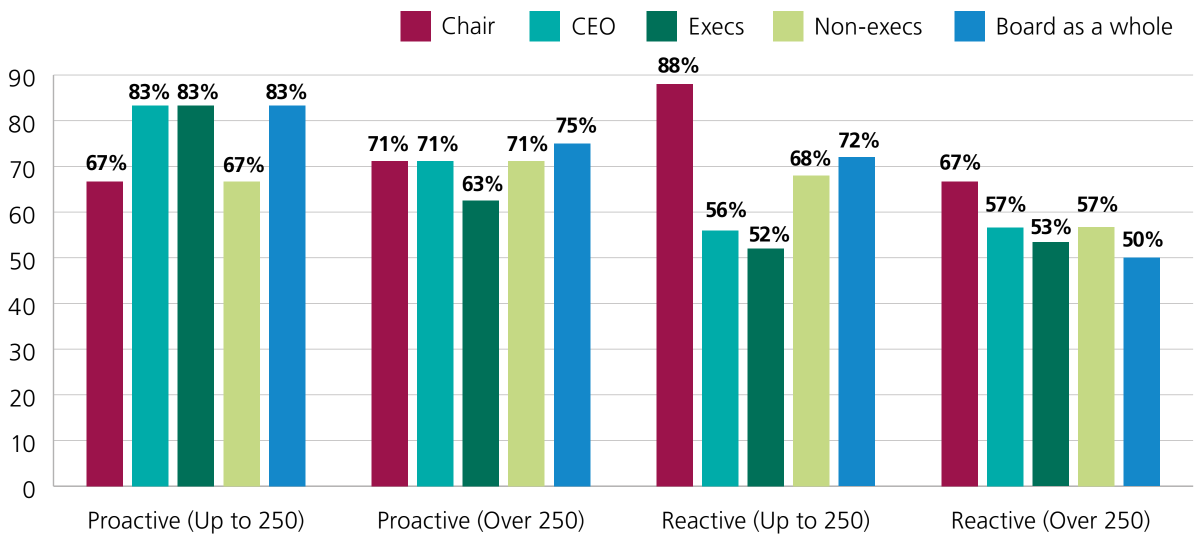
> *"It's making sure everybody's on the same wavelength, so it's a very informal process but it's done in that relational way."* Chair

4.2 Engagement with the board performance review

Companies do not always view board member engagement as an important aspect of a board performance review, which could be because the review is sometimes perceived as being of low value. The approach is often pragmatic, with individual board members being more or less engaged yet sufficiently engaged as a group to complete the exercise. Little awareness was in evidence of how to engage board members in the evaluation process or present a persuasive business case to obtain their buy-in. Overall, engagement levels by different boardroom roles are far from ideal, with reactive boards exhibiting lower engagement scores in both smaller companies (only 67% high to very high engagement) and larger companies (57% high to very high engagement).

The position exhibiting the most engagement is the Chair (88%) on a reactive board in a smaller company. The CEO, executives and NEDs are less engaged (56%, 52% and 68% respectively), suggesting that the Chair may be compensating for the lack of executive team engagement. It certainly appears to be the case that the executives and CEO are highly engaged on the proactive board of a smaller company. Engagement is generally and predictably poorer across all roles in a larger company with a reactive board, suggesting that engagement could be the key in making these boards more proactive. The results show that there is still room for improvement in engaging all key players in the board performance review process (**Figure 4**).

Figure 4: Throughout the formal board performance review process, how would you rate the level of individual engagement for each of the following?

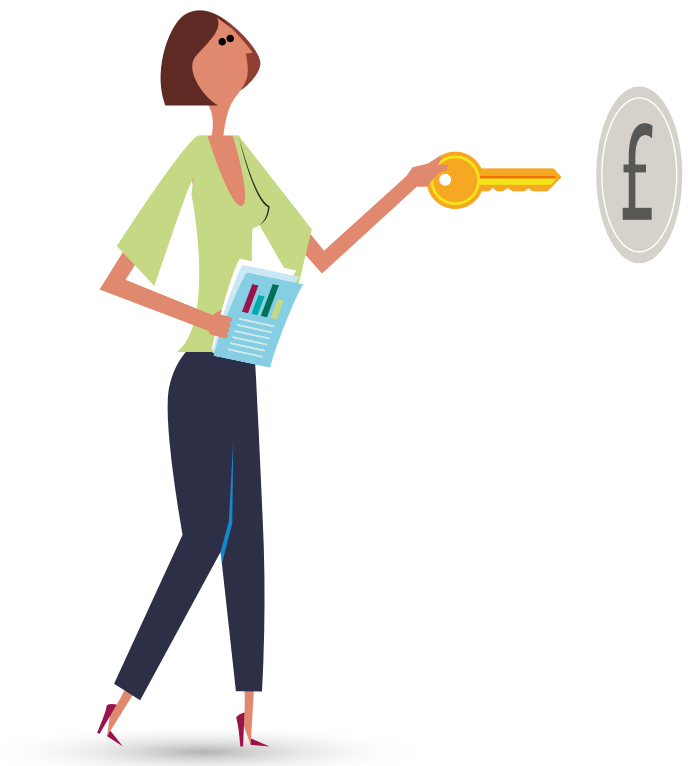


The Chair is acknowledged as being wholly controlling and can therefore dictate the climate of the board performance review. The personality of the Chair is sometimes given as a reason for not formalising the board performance review. Whether a board is relatively new or has worked together for several years, for the best outcomes the members need to be engaged in the evaluation process. The appointment of a new Chair can be a decision point for a different approach to board performance review, whether that be to make it more or less formulaic or more or less formal. The role of the internal facilitator or coordinator is recognised as being important. As well as being engaged, this person should be trustworthy, independent, respectful of confidentiality, and emotionally intelligent – characteristics most often attributed to a Company Secretary or Senior Independent Director. Alongside the Chair, these are pivotal roles in engaging the rest of the board.

> *"When you have a NED who turns up and all they do is tap their feet, do a contribution and leave, that's not good enough. And that's a difficult conversation to have but we have that."* Chair

> *"It was rather like pushing elephants upstairs when we started because there'd never been anything; it wasn't in the vocabulary of the board when I joined."* Chair

For investors, the role of the Chair is important in providing a balance across issues and overseeing company performance. The Chair can dictate the level of engagement in the boardroom and control how decisions are debated and reached. Investors will always welcome and encourage contact and dialogue with Chairs; in their opinion a good chair will undertake a board performance review and a bad one will not. The optimum scenario is where the board owns the evaluation: involving more advisors is not the solution, according to investors.



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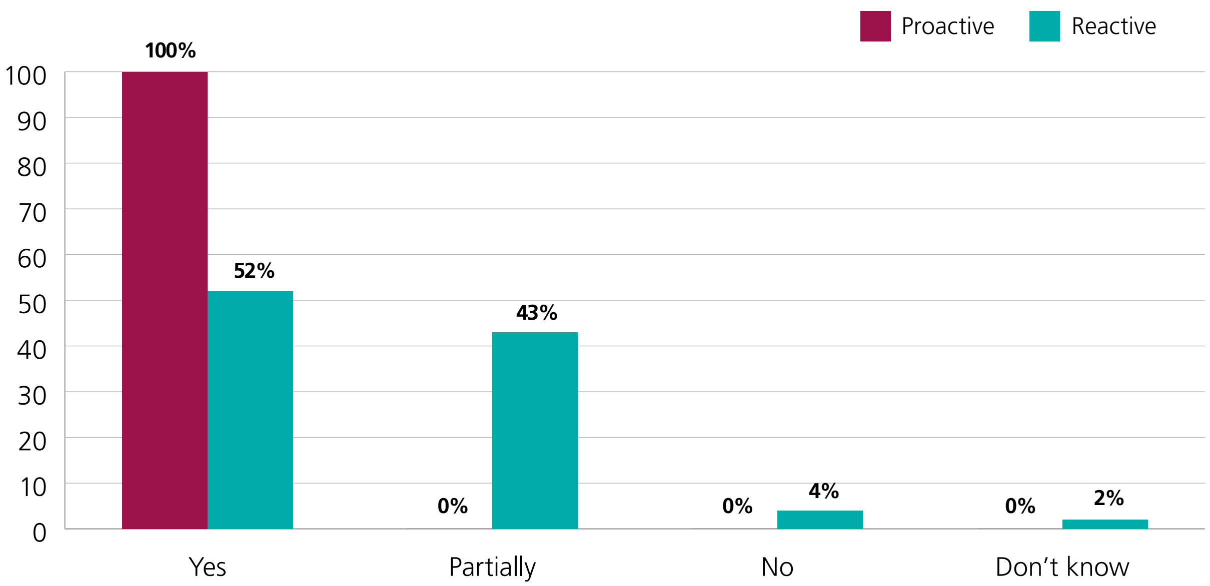
5. Topics and methods

5.1 Board performance review methods

In the opinion of board directors, board performance reviews should be highly context-specific if they are to be legitimate. As such, the review should be a dynamic exercise which reflects the tensions, decisions, issues and challenges the company faces. The topics under evaluation should change every year; some may remain constant but others will reflect the current year's circumstances (**Figure 5**).

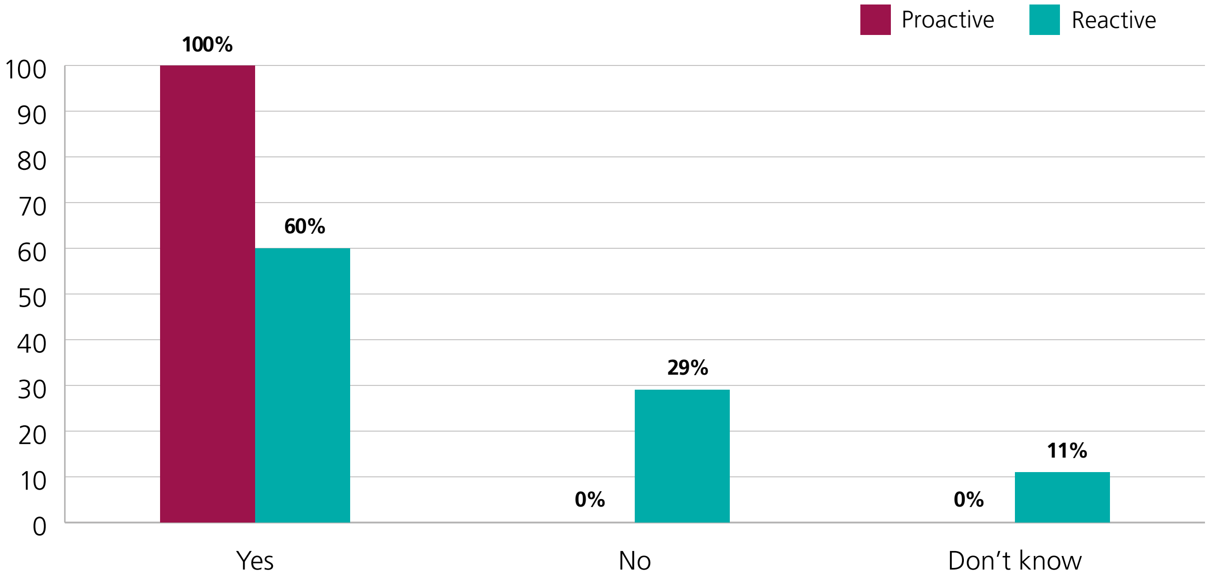
Figure 5: Are objectives from the board performance review made explicit from the outset?



The objectives of each year's board performance review should be discussed and decided explicitly every time. There is some awareness that companies can decide their objectives strategically: for example, aligning board performance with the aim of seeking a secondary stock exchange listing. Making the objectives of board performance reviews explicit is a key differentiator between proactive and reactive boards. Our survey data shows 100% of respondents on proactive boards do this, compared to only 51.8% of reactive boards. In addition, it appears that 42.9% of reactive boards make their objectives explicit to only a partial extent, making this an obvious area for improvement for reactive boards.

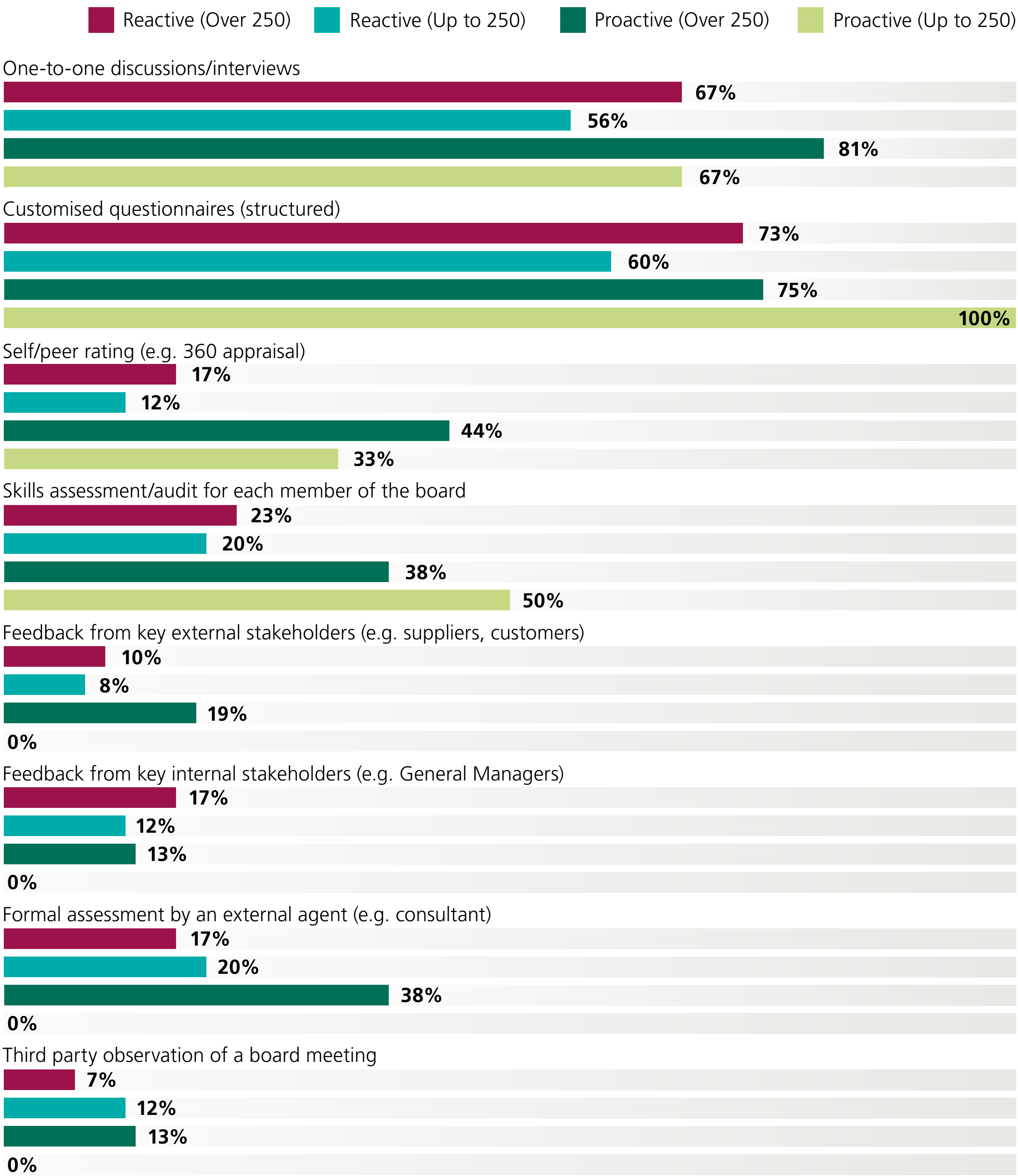
A similar picture is found when asking about follow-up from a previous board performance review: 100% of proactive boards but only 60% of reactive boards do this. Almost a third (29.1%) of reactive boards claim to undertake no follow-up from a previous board performance review (**Figure 6**).

Figure 6: Is there proactive follow-up from a previous board performance review?



The primary methods used in board performance review (**Figure 7**) by proactive boards are one-to-one discussions and interviews (77.3%) or customised questionnaires (81.8%). The least-used methods by proactive boards are self/peer rating and skills audits, both rated at 40.9%. The lowest scores were found for external or internal stakeholder feedback (22.7%) and board observation (9.1%); it is surprising to find that even proactive boards are relatively conservative in adopting these less common methods. The topics covered in board performance review by proactive boards were, unanimously: board composition, group dynamics, strategic direction and long-term value creation – all of which scored 100%. Communication with stakeholders, ESG and individual board member performance and engagement accrued the lowest scores, but nonetheless were cited by almost three-quarters of respondents (71.4%).

Figure 7: What methods are used to evaluate the board?

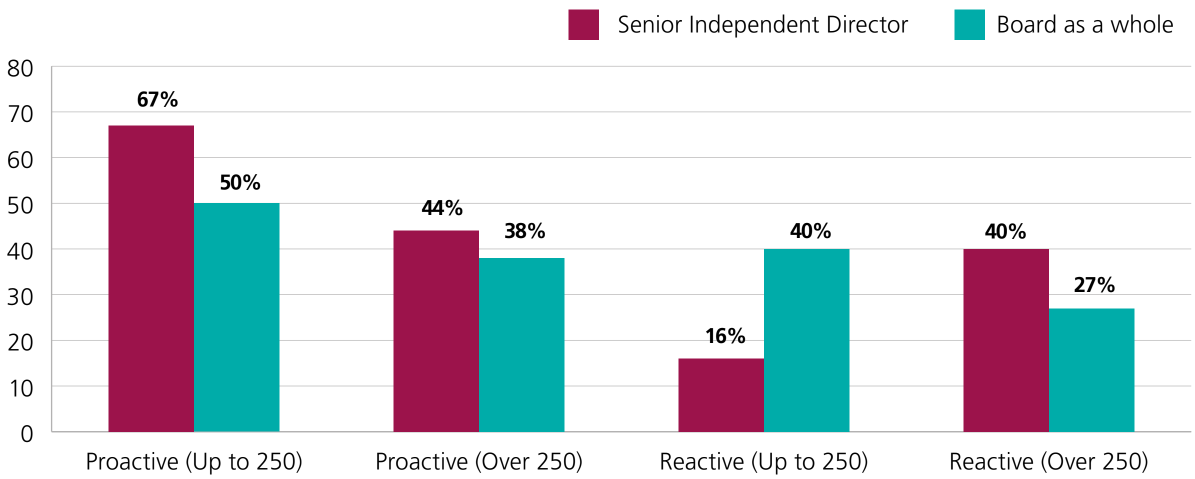


Customised structured questionnaires (72%) and one-to-one discussions/interviews (67%) are the most popular methods for board performance reviews. Only 13% of companies admit seeking the feedback of internal stakeholders (e.g. general management) and even fewer (10%) admit seeking feedback from external stakeholders (e.g. customers, suppliers). A board evaluation should not be just an inward-looking exercise.

Proactive boards in larger companies are most likely to use one-to-one discussions or interviews (81.3%) and also customised questionnaires (75%). They are least likely to use third-party observation or a board meeting (12.5%), or feedback from stakeholders; the minority that does engage with stakeholders are more likely to do so with external stakeholders (18.8%) than internal stakeholders (12.5%). Proactive boards in smaller companies always use customised questionnaires (100%), with half (50.0%) of them carrying out a skills audit of the board and a third (33.3%) adopting self and peer ratings. No proactive board of a small company claimed to seek any sort of stakeholder feedback or use a third-party service for assessment or observation. Companies with reactive boards showed remarkably similar patterns whether large or small.

Survey respondents told us that the majority of their structured internal board performance reviews featured a self-evaluation questionnaire. This sometimes comes from one of the 'big 4' audit firms. Alternatively, the questionnaire format is agreed by the Nomination Committee and/or board and then constructed from online sources which are benchmarked against the agreed approach. Questionnaires are sometimes tailored with the addition of traffic lights to grade the responses. One-to-one discussions or interviews are also very popular, more so for larger companies than companies with smaller boards and arguably more familiarity. Larger companies are twice as likely to seek feedback from external stakeholders, including advisers, than smaller ones, and 50% more likely to seek feedback from internal stakeholder groups. In those companies adopting a more informal approach, the evaluation is labelled a group or individual 'fireside chat' about how the board is working.

Figure 8: Who formally appraises the Chair?



Overall, the Senior Independent Director (36%) and the "board as whole" (35%) are by far the two main sources of Chair performance evaluation. However, 15% admit that "no one evaluates the Chair performance" and 3% don't know. Investors see Chair performance evaluation as critical.

When we asked who formally appraises the Chair (**Figure 8**), some respondents from smaller companies expressed surprise at the question, which we found telling. The survey results show that the SID appraises the Chair in two-thirds (66.7%) of proactive small-company boards and in 43.8% of cases in larger companies with proactive boards. Whole-board feedback about the Chair was evident in all scenarios but most prevalent in small companies (proactive 50.0% and reactive 40.0%). The SID was mostly absent from the Chair's appraisal in smaller companies with reactive boards (16.0%). This comparison of the highest and lowest results from the smaller companies illustrates that Chair appraisal is not related to company size.

> *"There's no particular set agenda; it's more around a grown-up chat around how the board work".* NED

> *"People know whether the job's being done well or not and you don't need to go through a form to assess it."* Chair

5.2 Board performance review topics

When it comes to the topics covered in board performance reviews, there are some clear distinctions between proactive and reactive boards, with proactive boards typically covering a broader range. And such coverage by proactive boards is more thorough in small companies than in large companies. However, on reactive boards, the range of topics is significantly narrower. The large-company reactive board focuses primarily on board composition (100%), board dynamics (96.7%), organisation of the board (96.7%) and strategic direction (93.3%). The small-company reactive board, by contrast, focuses on chair facilitation and leadership (83.3%), strategic direction (83.3%), communication with key stakeholders (79.2%) and decision-making processes (79.2%). Larger companies are less likely than smaller companies to include communication with key stakeholders in their board performance review. ESG receives the least coverage out of all topics by all companies, being included by only 29.2% of reactive boards in small companies. Again, these results show a clear pattern for proactive versus reactive approaches regardless of company size (**Table 2**).

Table 2: Which topics are typically covered in a board performance review?

Topics typically covered in a board performance review	Proactive Up to 250 (%)	Proactive Over 250 (%)	Reactive Up to 250 (%)	Reactive Over 250 (%)
Board composition (e.g. size, balance, diversity, degree of independence)	100	100	79.2	100
Chair facilitation and leadership	100	86.7	83.3	86.7
Communication with key stakeholders	100	60	79.2	66.7
Decision-making processes (e.g. monitoring)	100	80	79.2	86.7
ESG	83.3	66.7	29.2	50
Financial performance	83.3	80	54.2	53.3
Group dynamics of the board	100	100	66.7	96.7
Strategic direction and long-term value creation	100	100	83.3	93.3
Organisation of the board (e.g. agendas, length/frequency of meetings)	100	93.3	75	96.7
Performance and engagement of individual members (e.g. 360 feedback)	83.3	66.7	41.7	53.3
Professional development needs of board members	100	80	66.7	53.3
Succession planning (executive and non-executive)	100	73.3	70.8	63.3

The content of a board performance review needs to go beyond just composition of the board and skill sets/experience. It needs to encompass how commercial, strategic and engaged the board is, and address the depth and range of decision-making and level of challenge. Even informal board performance reviews reported by interviewees typically include such hygiene factors as the frequency and timetabling of board meetings, the length and timeliness of board papers and quality of discussion. They typically also focus on board composition in terms of skills and experience of individual board members and any training needs for the board or individuals. Executive operational performance is not considered part of a board performance review. Other areas of discussion were reported to include the articulation and long-term planning of strategy, risk management, internal control, shareholder requirements, and being a responsible and accountable business.

"It's very much more of a fireside chat, a general chat around." NED

"It can't be a tick-box exercise; it's a conversation. A board performance review is a conversation with some signposts." Chair

Investors feel that there should be consistency with the company's industry sector in terms of a general approach to content and methods. They tell us that evaluations are often very light on detail, and independence is not transparent so it's open to be challenged. The narrative about what constitutes the 'right' people on the board should include their appropriate skills and experience, independence, and accountability/engagement with the management team. Investors would like committees (especially audit and remuneration), as well as board directors, to demonstrate the appropriate skill sets.

"Board performance reviews are very, is a tricky one, because by definition self-evaluation is open to being highly subjective." CFO

"It has been a rather formulaic exercise." CFO

Many board performance reviews are very inward-looking, discussing only the hygiene elements of board management, e.g. board agenda, board papers or board dynamics. Board performance reviews need to consult a wider set of stakeholders to attain a genuinely holistic view of the board's performance. Our survey showed that feedback is sought from internal stakeholders in only 12.8% of cases and from external stakeholders in only 10.3% of cases. In contrast, respondents perceived added stakeholder value as a benefit of board performance review in around a fifth (20.5%) of cases. Direct assessment of the board by shareholders is welcomed by the investor community to show how corporate governance has improved. Adopting a more 360° and holistic approach, with input from both internal and external stakeholders, including advisers, can demonstrate a robust process with potential resolutions to real and challenging issues. Just as annual employee appraisals are now perceived in many quarters to be too disconnected and infrequent, perhaps the board performance review, too, needs to be more agile: a dynamic and perpetual dialogue which is revisited every quarter or 'just-in-time' after every board meeting. The inclusion of stakeholder input in the board performance review might also confer a marketing benefit – and possible competitive advantage – on a company: something that can add to the company's 'story' in its annual report and among the investor community.

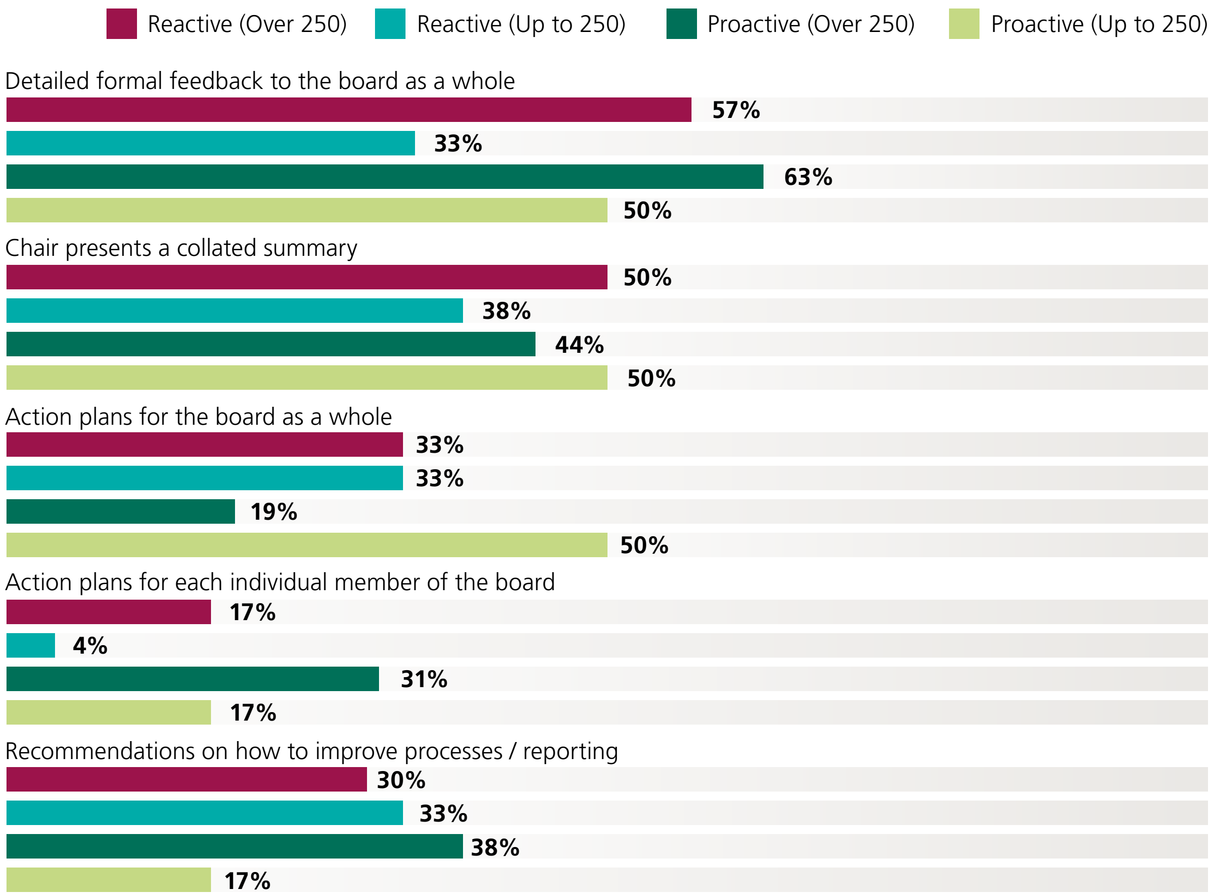
6

6. Outcomes, continuous improvement and disclosure

6.1 Board performance review outcomes and continuous improvement

When it comes to output from a board performance review, there is often a lack of clarity about what the board wishes to do with its conclusions (Figure 9). Often the exercise is formulaic, and merely completing the process is deemed to be a satisfactory, so there is little appetite for a formal action plan. It is therefore often challenging to promote a truly objective dialogue about problems on the board and how to resolve them. Board performance reviews can nonetheless sometimes trigger actions: they might be the tipping point that leads to the exiting of an executive or non-executive director, for example. When individual feedback is given, there is a likelihood that it is sanitised or diluted. When adverse feedback is given to a board colleague and taken personally, it can culminate in a negative experience for all board members which can distract from oversight of the business itself. There is no evidence of board members seeking or receiving training in giving constructive feedback; rather, it is merely assumed to be a skill possessed by all board members.

Figure 9: How are outcomes of the board performance review presented internally?



Overall, outcomes of a board performance review are most typically presented internally in the form of "detailed formal feedback to the board as a whole" (50%) or the "Chair presents a collated summary" (44%). Rarer outcomes are: the development of action plans for the board as a whole (32%); recommendations on how to improve processes/ reporting (32%); or action plans for each individual member of the board (15%). Large companies are most likely to provide detailed formal feedback to the board, with proactive boards doing so in 62.5% of cases and reactive boards 56.7%. Large companies also provide recommendations on how to improve processes and reporting, both for proactive boards (37.5%) and reactive boards (30.0%). The proactive board in a larger company is least likely to compile an action plan for the board as a whole (18.8%). Proactive boards in small companies typically find that the Chair presents a collated summary (50.0%), that there is detailed formal feedback to the board (50.0%), and that there are action plans for the board as a whole (50.0%). The proactive board in a large company is best at providing action plans for each individual board member (31.3%), but the same kind of board in a small company is the least likely to include recommendations on how to improve processes and reporting, indicating the informality in approach we mentioned above. Action plans for each board member are the least likely outcome for reactive boards in small companies (4.2%). These results suggest that there is a reluctance to experiment with different methods and topics within board performance review.

Table 3: What are the tangible benefits of a board performance review?

Tangible benefits	Proactive boards (%)	Reactive boards (%)
Strategy and competitive advantage	27.3	16.4
Innovation and new ideas generation	13.0	10.9
Value creation	31.8	14.5
Improved sustainability	22.7	10.9
Added stakeholder value	31.8	16.4
Improved board performance as a whole	**86.4**	**69.1**
Improved individual performance of board members	**68.2**	**56.4**
Greater shared understanding	59.1	47.3
Improved governance	**68.2**	**58.2**
Improved diversity/board composition	31.8	38.2

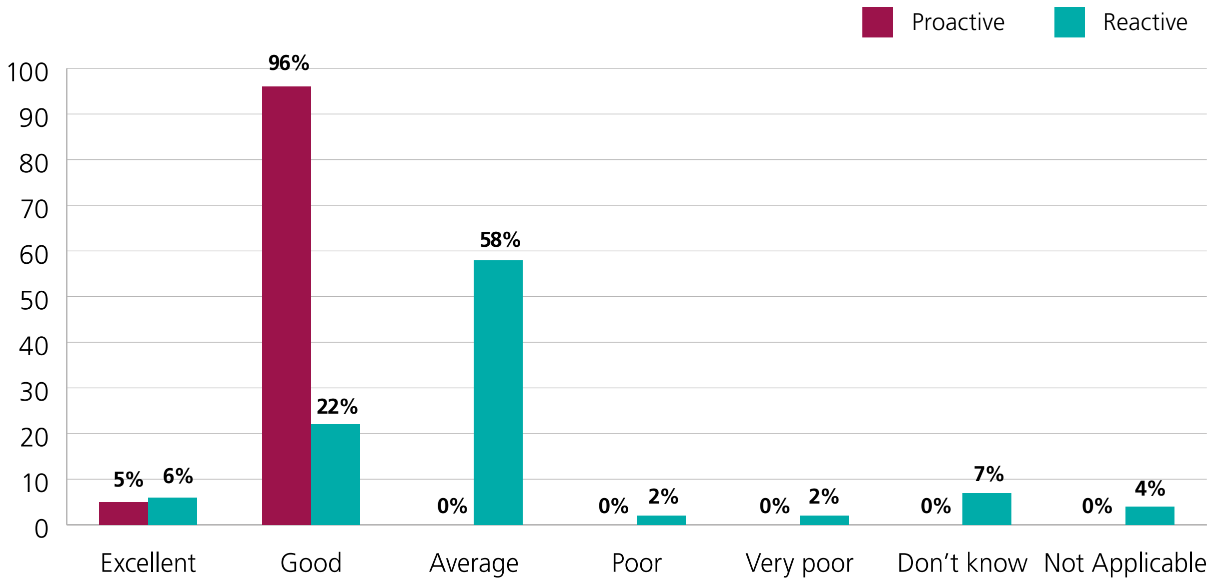
The tangible benefits of a board performance review (Table 3) for proactive boards are perceived to be: improved board performance (86.4%), improved governance (68.2%) and improved individual board member performance (68.2%). If these benefits are realised, we propose that there is an opportunity being missed by companies to promote the thoroughness of process and effectiveness that has resulted from board performance reviews. The reactive boards rated the same three areas as the greatest areas of tangible benefit. Again, these results show a very inward-looking board-facing attitude, yet concerns about board composition, such as diversity, are only flagged by approximately a third of both proactive (31.8%) and reactive (38.2%) boards.

> *"I really need to get this revisited, because it almost feels, talking to you now, we've done a bit of a tick-in-a-box, and we haven't followed it through."* CEO

> *"We've come up with a thing that says, 'here are the three things we should do better' and we've put that in our annual report, and then we've done absolutely nothing about them."* Executive Director

With regard to the effectiveness of the board at applying board performance review recommendations (Figure 10), there is a stark difference between proactive and reactive boards. Respondents on proactive boards rate this activity as either good (95.5%) or excellent (4.5%), whereas on reactive boards it is largely average (58.2%) or good (21.8%). There is a greater span of views on reactive boards and more of a consensus on proactive boards.

Figure 10: How effective is the board at applying the recommendations from an evaluation?



The **QCA/UHY Hacker Young AIM Good Governance Review 2020/21**[8] found two areas of board performance review lagging for AIM-quoted companies, and both of these were based on Principle 7 of the QCA Code. There was a drop of 2% – from 16% in 2019 to 14% in 2020 – with regard to the principle of board performance review being based on clear and relevant objectives and which seeks continuous improvement and detailed description with performance criteria. In contrast, the board performance review overview, how it is conducted, the results and recommendations and progress against previous actions improved from 38% in 2019 to 46% in 2020.

Investors state that it is difficult to glean evidence of the quantity or quality of recommendations resulting from a board performance review as they are not participants and only hear or read about outcomes from decisions. Investors are not offering any perfect solutions here, but they would like more objective data – and this doesn't mean more meetings with NEDs. Investors agree that the worst thing a company can do is to fail to carry out a board performance review, even if small and mid-sized quoted companies are reporting less than optimum independence. Independence and transparency are important to investors; however, if these are compromised in a company, then investors would at least like to know how the company is attempting to mitigate the risk, if not also realising value.

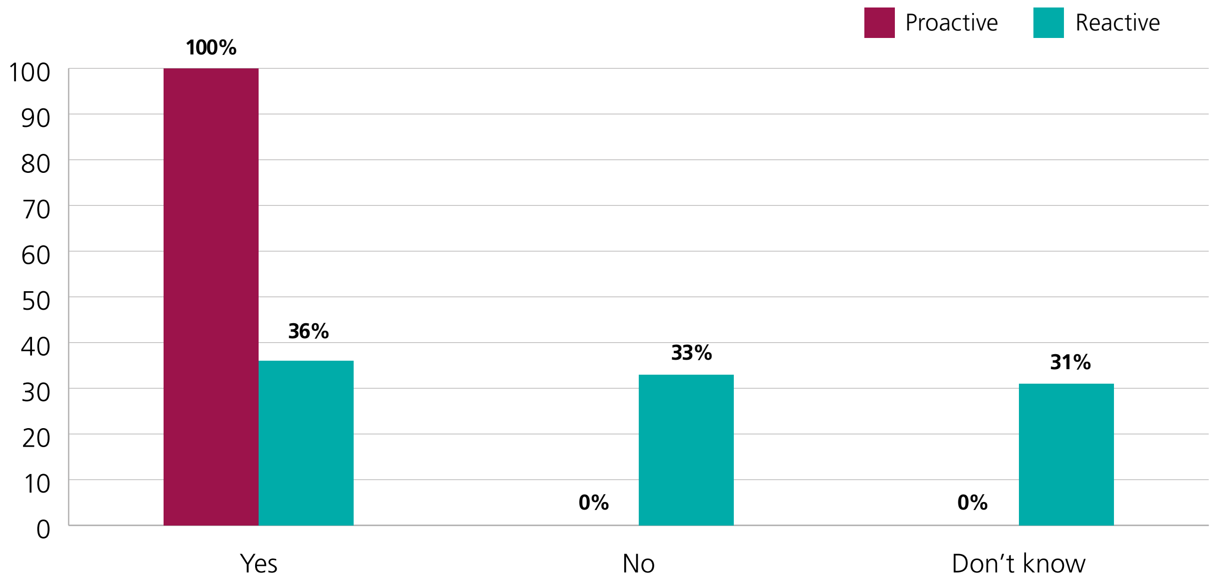
> *"It didn't get to the bottom of what I could see as any of the problems, and it gave the board a good tick in the box."* NED

> *"We went through the evaluation with no set agenda and, as we came out of it, we then set objectives as to what we wanted to do."* CFO

[8] Quoted Companies Alliance (2020). **The QCA/UHY Hacker Young AIM Good Governance Review 2020/21** bit.ly/3ewkTit

There appears to be a general lack of dynamism and reactivity in the board performance review process, together with insufficient linkage to the marketplace and business events. It is unclear from interviewees how robust the process of follow-up is from one annual evaluation to the next. The survey results show that 100% of proactive boards always change their objectives for each evaluation. This undoubtedly keeps the process fresh and dynamic, and will help to engage board members in the process and outcomes. The reactive board results show no clear picture with a range of affirmative, negative and uncertain viewpoints (**Figure 11**).

Figure 11: **As a result of the arising actions, do objectives continuously change for subsequent evaluations?**



Investors feel that the label 'board performance review' mistakenly places the emphasis on what is going wrong; the review would be better received if it was more about board improvement and had a more developmental emphasis. The current label (an improvement on 'board evaluation') reflects the fact that the key driver is compliance (and the path of least resistance) rather than stewardship, which would be preferable. The whole approach to board performance review needs to be reframed as the continuous improvement of the board. Investors would welcome board performance review being rebadged as "board effectiveness or improvement reviews". Consistency is also important to the investor community so they can track year-on-year improvement. Small and mid-sized quoted companies should consider how they fill the potential gap between what goes on in the boardroom and what is publicly available to investors and brokers. This includes being transparent about business challenges and how solutions are working.

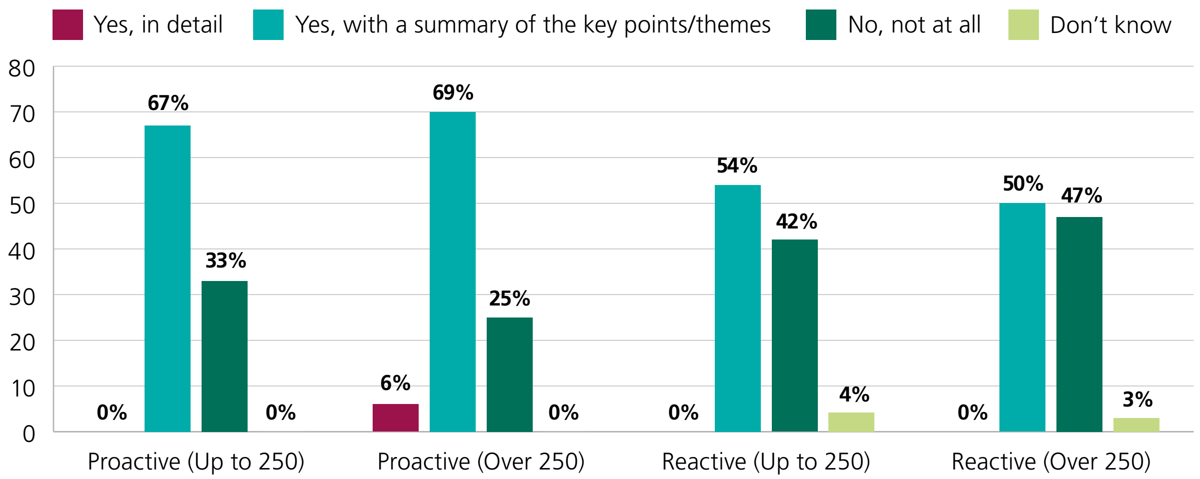
> *"Every board meeting, we go back to those board performance review outputs and see the benefit of those outcomes in the board meeting and see them as being implemented."* Chair

> *"It's not really used for anything other than satisfying the corporate governance box-ticking."* Chair

6.2 Board performance review disclosure

So, what does 'good' look like when presenting the outcomes of the board performance review in the annual report? Our results show that very few companies actually do this in any detail: in fact, only 6.3% of proactive boards in large companies. The majority of proactive boards will disclose in their annual report but only a summary of key points (66.7% of small companies and 68.8% of large companies) (**Figure 12**).

Figure 12: How are the outcomes of the board performance review presented in the annual report?



Overall, 56% of surveyed companies present a summary of the key points/themes in the annual report but only 1.3% present the results in detail. Some 39% present no board performance review information and 4% don't know.

Reactive boards disclose with a summary of key points in approximately half of all cases. There remains a significant proportion of companies across all groups that do not disclose board performance review outcomes at all in their annual report, although it is less marked with proactive boards. This area has been highlighted by the FRC in its recent (November 2020) **Review of Corporate Governance Reporting**[9], in which they conclude: "there remain concerns in relation to companies providing sufficient details about the outcomes from the evaluation process. This is possibly due to a fear of market reprisal in Annual Report publication."

[9] FRC (November 2020). Review of Corporate Governance Reporting bit.ly/2Poo97e

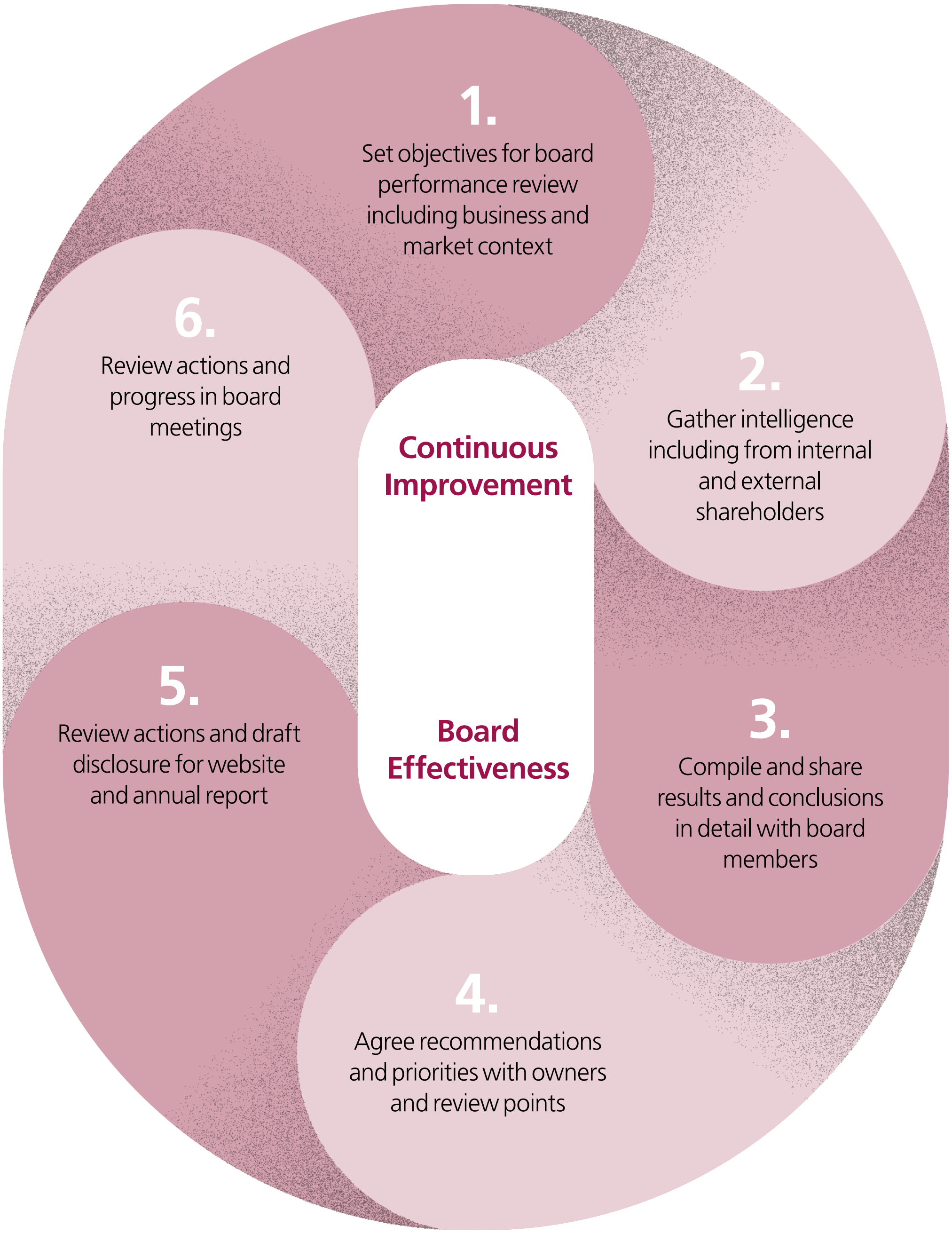
7

7. Summary and Conclusions

These survey and interview results on board performance review have been analysed using a framework of proactive and reactive boards within large and small UK listed companies. The differences and similarities between how these groups approach board performance review has distilled a variety of formal and informal approaches.

We have discussed board performance review within the context of formality and informality. Our stance is that informality can be positive but depends on the reality of board member engagement. Informality is not the same thing as inactivity. The investor perspective is that inactivity is misguided and a missed opportunity for companies to promote their successes as well as their awareness of progress on addressing issues.

Figure 13: Cycle of good board performance review practice



Education for small and mid-sized quoted companies is key, and wholly supported by the investor community. Improvement equals growth, and so improving the realised value from board performance reviews is good for the company and the investor community. There is a need to move away from compliance as the sole driver and focus instead on the output, as actions at the end of the process are critical. To go through an evaluation process and yet have nothing to improve on is not a credible position. These survey results also highlight the role of the Company Secretary, which has scope to be more proactive, strategic and action-oriented with a focus on year-on-year progress.

Appendix

Current approaches to board performance reviews in small and mid-sized quoted companies

LARGE & MATURE

Company Size & Stage

SMALL & ENTREPRENEURIAL

Large & Mature / Reactive

- **Driver:** Driven by member of executive team or Chair.
- **Engagement:** Chair is most engaged and board as a whole is least engaged. SID appraises the Chair.
- **Methods most used:** customised questionnaires and one-to-one interviews.
  Methods least used: third-party observation or external stakeholder feedback.
- **Topics least likely to be covered:** professional development, ESG, financial performance and individual board member performance.
- **Outcomes** presented as detailed formal feedback to board as a whole.
- Presented in annual report as a summary or not at all.
- **Benefits perceived as:** improved board performance and improved governance.

Large & Mature / Proactive

- **Driver:** driven by a member of executive team.
- **Engagement:** board as a whole is most engaged and executives least engaged. SID appraises the Chair.
- **Methods most used:** one-to-one interviews and customised questionnaires.
  Methods least used: internal stakeholder feedback and third-party observation.
- **Topic least likely to be covered:** individual board member performance and communication with key stakeholders.
- **Outcomes** presented as detailed formal feedback to board as a whole. Presented in annual report as a summary.
- **Benefits perceived as:** improved board performance and improved governance.

Small & Entrepreneurial / Reactive

- **Driver:** driven by Chair and Company Secretary jointly or by Company Secretary alone.
- **Engagement:** Chair is most engaged and executives are least engaged. Board as a whole appraises the Chair.
- **Methods most used:** customised questionnaires and one-to-one interviews.
  Methods least used: external stakeholder feedback.
- **Topics covered:** primarily strategic direction and Chair's leadership.
- **Outcomes** presented by Chair as a collated summary. Presented in annual report as summary or not at all.
- **Benefits perceived as:** improved board performance and greater shared understanding.

Small & Entrepreneurial / Proactive

- **Driver:** driven by either Chair or Company Secretary jointly or Chair alone.
- **Engagement:** board as a whole, CEO and executives are most engaged with Chair with NEDs being least engaged. SID appraises the Chair.
- **Methods most used:** customised questionnaires and one-to-one interviews.
  Methods not used at all: external assessment or feedback from any stakeholder.
- **All topics covered.**
- **Outcomes** presented as action plans for board as a whole. Presented in annual report as a summary.
- **Benefits perceived as:** improved board performance and greater shared understanding.

REACTIVE — **Board Performance Review Approach** — PROACTIVE

About the QCA

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small and mid-sized quoted companies.

The value of our members to the UK economy is vast – as is their potential. There are around 1,250 small and mid-sized quoted companies in the UK, representing 93% of all quoted companies. They employ approximately 3 million people, representing 11% of private sector employment in the UK, and contribute over £26bn in annual taxes.

Our goal is to create an environment where that potential is fulfilled. We identify the issues that matter to our members. We keep them informed. And we interact to build the understanding and connections that help our members stay ahead. The influence we have, the influence we use, and the influence we grow ensures that our members always benefit from the impact of our initiatives.

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