Establish a Formal Process for the Board's CEO Oversight

The CEO runs the company, but the board must take responsibility for the lead executive's performance. **BY DOUG RAYMOND**

It is a fundamental principle of corporate law that the responsibility for managing the corporation sits squarely on the shoulders of the board of directors. As Delaware law states, "The business and affairs of every corporation … shall be managed by or under the direction of a board of directors…" But, in almost every business, the board delegates most of this responsibility to the officers — principally the chief executive officer, who typically hires the rest of the management team.

Notwithstanding this delegation of its authority, the board retains the obligation to oversee the management team and to ensure that the officers are performing at a high level, consistent with the strategic direction and the values of the company. Inevitably, most of the responsibility for this falls to the CEO, on whom the board must rely to operate the business on a daily basis. And CEOs have become accustomed to extensive autonomy in running the business.

Because the board relies so heavily on the CEO, it is often said that the most important duties of the board are the decisions to hire and fire the CEO. However, in part because of the crucial importance of the CEO role, the extensive involvement of the board in their hiring and the close relationship that a CEO has with the directors, the board is naturally very invested in the CEO's success. This investment and alignment are crucial for the board to be able to work effectively with management, but they can also make it difficult for the board to be objective in assessing the CEO's performance. As was reported in one possibly apocryphal story of when a new director joined the board of a global corporation, the new recruit asked a veteran director about the principal duties of the board with respect to the CEO. The answer? "Applause."

During the height of the pandemic and the social and political controversies that occurred at the same time, there was significantly less turnover reported at the top of public

companies compared with prior periods, according to Conference Board analysis. While the board's support of senior management in the face of these unprecedented challenges is understandable, the challenges do not appear to be abating, at least not for most businesses. The directors' fiduciary obligation to oversee the management of the corporation in the best interest of the shareholders and other constituencies includes oversight and evaluation of senior management, particularly the CEO. And despite the natural inclination to be supportive, in this evaluation the directors must not be overly deferential to the CEO. At the same time, the directors must also avoid becoming oppositional or intrusive.

The directors' duty of oversight is not limited to an assessment of the company's financial and stock performance, which realistically is often not really within the CEO's control. They also should evaluate how the CEO interacts with the board and the rest of the organization, including employees, stockholders and other constituencies, as well as the extent to which the CEO supports the board's strategic vision and the company's core values. Directors also should consider whether the CEO is sufficiently candid with the board or instead sugarcoats or deflects bad news when possible.

The recent Conference Board report also suggested that, notwithstanding the current extensive focus on diversity and inclusion, recently appointed CEOs remain overwhelmingly male and white. While each board must decide for itself the role that diversity should play in management and in the boardroom, institutional investors are increasingly focusing on this and other extra-financial issues, including sustainability and how the company engages with contentious political and social issues. As CEOs are required to navigate an increasingly complex set of issues beyond financial return and stock prices, the board must be attentive to the messages that management is sending to investors, employees, customers and other constituencies.

The success or failure of the CEO is the board's responsibility, and the board should make sure that it has taken full responsibility for the CEO's performance.

While boards will address these issues in many ways, boards should consider establishing a regular and well-articulated process for evaluating the CEO. This process should look back to the criteria that the board employed when the CEO was first hired, but also should address the current strategic focus of the business and other issues that are current board priorities. In too many companies, the CEO is not given a performance evaluation at all, or, if one is given, it is too often limited to determining whether the financial metrics have been met. If the board establishes a relatively formal process, with a clear cadence, it can avoid personalizing the evaluation or putting the CEO on the defensive. Especially if an outside consultant or advisor is involved, the evaluation can be structured to minimize both the risk of unwarranted deference and injury to the relationship between the board and the CEO. Depending on the board's structure, either the compensation committee or the governance committee can take responsibility for this evaluation, involving other directors and select members of senior management to make sure that the committee has a comprehensive view.

While a process that includes a periodic formal assessment of the CEO will not guarantee that the board's oversight obligation is limited to applause, it should encourage directors and the CEO to actively engage in the process. Ultimately, the success or failure of the CEO is the board's responsibility, and the board should make sure that it has taken full responsibility for the CEO's performance. ■

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