viewpoint
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CEO EVALUATION

A missed opportunity

It's a bit ironic that when you rise to the level of CEO, arguably the most important position in an organization, you are less likely to get candid feedback that will help you succeed. As we heard from one CEO in a recent study that The River Group conducted, *"It is very difficult to get unvarnished feedback about how I am doing. I ask for it, but I am not sure I ever really get it. 360s help a lot, because they are anonymous. But, I'm not sure even my Board gives me feedback that is their real opinion."*

Leaving value on the table

While it remains one of the most important responsibilities of boards of directors, the process for setting expectations, completing CEO performance reviews, and providing feedback is often neglected or poorly designed and implemented. All too often, boards and CEOs treat the CEO evaluation process as an administrative requirement and engage in relatively cursory conversations about goals and results. "Or, the board is reluctant to challenge the CEO or is concerned about alienating him or her by delivering critical feedback." Typically, in publicly held companies, the primary focus of the evaluation is on whether or not the CEO met financial expectations that impact his or her compensation. As one director put it, *"We just need to know if he made his numbers, or not."* In our view, companies that take a perfunctory and narrow approach to CEO evaluations are leaving value on the table.

Seizing the opportunity

Some forward-looking boards and CEOs are bucking historic trends and approaching the CEO evaluation process not as a mandatory administrative procedure but as an opportunity to advance and sustain the value of their companies. The benefits they are reaping include:

Direction, alignment and results

An effective CEO evaluation process drives the board, CEO and executives to crystalize strategic direction and priorities, regularly track progress, and make adjustments. That laser-like focus on a common set of goals drives higher performance and delivery of results, not just for the CEO personally, but for the entire company.

Agility

A well designed and managed CEO evaluation process also fosters the kind of open dialogue and trust between the board and CEO that allows them to quickly raise and efficiently resolve problematic issues. The resulting agility in framing and making decisions allows companies to seize opportunities that provide a strategic advantage and avoid getting mired in unresolved issues that could slow progress or damage the company.

A stronger CEO

Identifying and advancing development opportunities as part of the evaluation process builds the capability of the CEO to lead the company and influence his/her industry. The ability to consistently improve CEO effectiveness becomes a valuable company asset.

Leadership brand equity

When analysts and investors see that the board, CEO and executives are aligned on a common direction and capable of executing strategy, they value the company more highly. That leadership brand equity contributes to a higher stock price for the company (from *The Economist*/Mercer report on *"The Economic Value of Leadership Brand"*).

Guiding principles

While the high level process for planning and evaluating CEO performance is relatively straight forward, the nuances about how the performance expectations and evaluation criteria are set, assessment is completed, board is engaged in discussing results, and feedback is delivered and discussed with the CEO, play a huge role in determining the value that can be gained from the process. Below are some guiding principles for realizing the benefits of an effective CEO evaluation process.

1 *Make it a collaborative process between the CEO and board.*

While the board owns ultimate accountability for designing and managing the process, the CEO should play a proactive role in defining goals, deciding what information to collect and how, and determining how results will impact compensation. That collaborative approach will lead to better decisions about what to assess and how, and it will help avoid turning the process into an administrative exercise that adds little value.

2 *Establish a balanced set of evaluation criteria and financial incentives that focus the CEO on driving short- and long-term growth of the business.*

To ensure appropriate balance, some companies create two sets of criteria. First is a "CEO Scorecard," which shows the corporate performance goals and metrics for which the CEO is ultimately accountable. Typically it is organized into a few broad categories such as financial, operational, customer, and human capital. The second set of criteria is a "Leadership Assessment," which evaluates the CEO against a set of leadership dimensions and capabilities required for sustaining long-term success of the company. While the CEO's compensation should be designed to appropriately reward performance against annual financial and operational goals, the compensation model should also reward CEOs for achieving goals that go beyond short-term financial metrics and contribute to sustainable value creation.

3 *Gather quantitative and qualitative data from multiple sources.*

In order to accurately evaluate the CEO's performance, the board should gather data on results against the business metrics defined in the CEO scorecard, and it should get input from reliable sources who have direct observations of the CEO's performance and leadership. Ideally, those sources should include all board members, the CEO, and key members of the CEO's leadership team. In some cases, it may also be helpful to get input from external stakeholders (e.g., partner organizations, customers, etc.). Input can be gathered through confidential surveys and/or interviews and organized into a draft report to be refined by the Compensation Committee or sub-group of the board that is responsible for completing the CEO evaluation.

4 *Align the full board on the CEO's evaluation.*

Before providing feedback to the CEO, the full board should receive the CEO evaluation report, engage in a discussion about the results, and align on a core set of messages to be delivered to the CEO about his/her performance and suggested business and developmental priorities for the following year. Gaining alignment among directors helps avoid sending mixed messages to the CEO about his performance and future direction for the company.

5 *Ensure ongoing, candid discussions with the CEO about his/her performance.*

Don't wait for the annual review process to provide feedback—make it an ongoing part of the dialogue between the board and CEO. For the formal annual process, ensure that the responsible board members make it a candid, constructive dialogue with the CEO. Listen to the CEO's perspective about his/her performance, share key conclusions from the full board—with no punches pulled, and agree upon business and developmental priorities for the coming year.

Where are you on the River Strength Meter?

THE RIVER STRENGTH METER

WEAK		MODERATE		STRONG	
Nominal	Subjective Reflection	Administrative Compliance	Standard Procedure	Value Enhancing	Equity Building
Little or no formal evaluation process exists. A few board members decide on the CEO's compensation, without formally evaluating performance.	Annual CEO goals are not defined. The board subjectively discusses performance and awards compensation.	Formal financial goals are set and results are reported. The board discusses financial results and decides on CEO compensation.	Evaluation criteria include a balanced set of metrics. All board members provide input. The board chair discusses feedback with the CEO. Financial results drive CEO compensation.	CEO is evaluated on business and leadership metrics. Input is gathered from board members and selected executives. The CEO discusses results with the full board. Non-financial results contribute to compensation.	Evaluation criteria and financial incentives drive long-term value creation. Robust data are gathered from all relevant sources. Full board is aligned on core messages. CEO proactively addresses development opportunities.

CEO EVALUATION

The River Group was formed by clients for clients. The founders met 15 years ago as CEO client and consultant. Over the years, we have worked on many successful transformations together.

This track record of success and fruitful collaboration led us to form The River Group as specialist leadership advisors.

With the client/consultant perspective, The River Group is a different kind of consulting firm. We combine years of experience leading change ourselves or advising others on leading change.

We have the behavioral know-how of consultants and the focus and pragmatism of the CEO.

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