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INTERNATIONAL ACADEMY FOR QUALITY

"A community of the world's leading executives, practitioners and academics dedicated to promoting the cause of quality"



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Academicians Marcos E. J. Bertin and Gregory H. Watson

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Abstract:



Performance distinctions between competing organizations begin with the strategic direction and policy formulation as established by the Board of Directors while an organization's capacity to sustain long-term success is established by management's ability to assure control using a disciplined approach to daily control based on Board guidance and advice. Recent developments over the past decades have had a sobering effect on Boards of Directors as they recognize their innate responsibility to assure quality of results in both strategic and operational dimensions of organizational performance. An emerging emphasis on quality has been elevated to the level of the Board of Directors as they are being increasingly held accountable for the quality of their organization's operating activities as well as its performance results. This paper briefly traces the development of this new perspective on quality at the level of the Board of Directors and presents an approach to conduct an internal assessment of the performance of a Board of Directors as developed by the International Academy for Quality.

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Requirement Come Out of the Crisis!

In the past two decades we have suffered two crises of governance:

- A moral crisis due to misdirected leadership and abuse of authority.
- A financial crisis due to loss of fiduciary responsibility.

What is the problem in knowing how to exercise good governance?

Limitations of Knowledge – what can we know about our organizations?

| Type of Data | Explanation of Data | Nature of Data |
|-----------------|--|----------------------|
| Physical data | Continuous variables (engineering quality data) | Tangible |
| Biological data | Ergonomic data (time and motion) | Less Tangible ↓ |
| Process data | Timing and attribute data (pass/fail compared to criteria) | |
| Economic data | Approximations (estimates based on probability forecast) | More Intangible ↓ |
| Political data | Leadership and strength of relationship (fixed scale/rank) | |
| Social data | Interactions or relationship (group norm relativity) | Intangible |
| Moral data | Values or personal philosophy (individual relativity) | |

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How can we know? By what means can we learn?

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Meaning of Quality in Governance:

What does it take to deliver good quality in corporate governance?

- **Principle of Ownership** – Ownership describes the way a person cares for a resource. Owners preserves capital and manages risk to achieve the desired return.
- **Principle of Stewardship** – Stewardship directs a person to take responsibility in the way they manage resources that have been entrusted into their care by an owner (e.g., preserve or enhance the value of capital investments). Stewardship preserves value and exercises due diligence in the managing organizational resources to achieve its purposeful ends.
- **Principle of Accountability** – Delegation of authority and resources from an owner to a designated steward requires accountability for how this authority is used and how resources are deployed or consumed.

Good governance ensures that organizations take into account the interest of a wide range of constituencies and the board of directors is accountable to the company and its constituents.

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OECD Principles of Corporate Governance

| Principle | Brief Description |
|--|---|
| Ensuring the basis for an effective corporate governance framework | The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities |
| The rights of shareholders and key ownership functions | The corporate governance framework should protect and facilitate the exercise of shareholders' right |
| The equitable treatment of shareholders | The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights |
| The role of stakeholder in corporate governance | The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises |
| Disclosure and transparency | The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company |
| The responsibilities of the board | The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders |

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IAQ Approach: Board Values & Concepts

Purpose: Evaluate adequacy of Board operating system and processes:

Leadership: sets directions and defines values aligned to constituent needs.

Independence: independent and holds management accountable for results.

Ethics and Transparency: ensures ethical behavior and fiduciary compliance.

Distinction between Governance and Management: defines the strategic guidance, evaluates management effectiveness and holds the management accountable for results. Implementation is management's responsibility.

Focus on well documented processes that add value: creates constituent value applying transparent, and well-documented key business processes.

Focus on results: focuses on results, not on procedures, tools or structure.

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Structure of the IAQ Assessment Method:

Management assigns a score based on the level achieved and points are set based on within level performance strength:

| 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 |

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Category 1: Mission and Principles

Level 1:

- The board is not active in establishing the Values and Mission of the Company.
- The Values and Mission have not been established or are not in use.
- There are no signs of the utilization of the Country laws, including the spirit of the law, as a complete operational framework for the Company.
- The BOD/Management/Company lack a comprehensive understanding/acceptance of possible liabilities.
- Information on board activities and decisions are kept to some members of the board, and are not disclosed at all levels.
- There are no policies regarding risks and crisis management.
- The board has not adopted a Code of Best Practices, including subjects such as:
 - Code of Ethics; potential conflicts of interest among Shareholders, Board members and Management;
 - Nomination and election process for Board members;
 - Adoption and use of internationally accepted standards.

Level 2:

- Values and Mission of the Company have been established but with no formal participation of the Management team.
- The Values and Mission have been communicated, but employees are not committed to them.
- The Company intends to operate in compliance with the spirit of Country laws, but there is no process to ensure this.
- The BOD is aware of its liabilities as well as of those of the Company. There is no process to mitigate risks.
- There are policies related to risks and crisis management, but they are not properly communicated or enforced.
- The board has adopted a Code of Best Practices, including subjects as:
 - Code of Ethics; potential conflicts of interest among Shareholders, Board members and Management
 - Nomination and election process for Board members
 - Adoption and use of internationally accepted standards, but its implementation has not been completed or enforced.

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Category 1: Mission and Principles

Level 3:

- The Values and Mission of the Company have been established with Management participation.
- The Values and Mission have been deployed within the Company, and are shared by employees.
- The Company operates in full compliance with Country law and with the spirit of the law.
- The BOD is aware of its liabilities as well as of those of the Company. There is a risk mitigation process.
- There are policies regarding risks and crisis management, which are communicated and enforced by the organization.
- The board has adopted a Code of Best Practices, including subjects as:
 - Code of Ethics; potential conflicts of interest among Shareholders, Board members and Management
 - Board members' nomination and election process
 - Adoption and use of internationally accepted standards and it is fully operational.

Level 4:

- The Values and Mission of the Company are proactively established by the board, with Management participation.
- The Values and Mission are fully deployed within the Company. Employees are fully committed to both.
- The Company operates in full compliance not only with Country laws but also, and more importantly, with the spirit of the law, and there is a process to ensure its sustainability.
- The BOD is fully aware of its own liabilities and those of the Company and uses a process to anticipate and mitigate risks.
- There are comprehensive, updated policies for risk and crisis management. Crisis management rehearsals are performed.
- The board has implemented a Code of Best Practices, including subjects as:
 - Code of Ethics; potential conflicts of interest among Shareholders, Board members and Management
 - Board member nomination and election process
 - Adoption and use of international standards is operational and Company is aware of new developments in these areas.

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Category 2: Board Structure

Level 1:

- Chairman/CEO functions:
 - There is no separation between Chairman and CEO roles.
 - There is no lead director
- There are no external, independent Directors.
- There are no Board Committees, nor is the board performing those functions.
- Board members as a whole do not have the collective knowledge to make a significant contribution to the company.
- Board size is not adequate for effective board performance.

Level 2:

- Chairman/CEO functions:
 - Chairman and CEO are two separate functions; or,
 - There is no separation between Chairman/CEO roles, but the company is in the process of incorporating a lead director.
- The need for external, independent Directors has been established. The process is in progress.
- Board member selection on the basis of knowledge, experience, personality and expected-contribution has not yet reached full implementation.
- Board size has been identified as an issue. A process to correct this situation is underway.
- Board Committees:
 - The need for Board Committees has been established, but is still in the implementation phase; or,
 - The board is starting to assume basic Committee functions due to its small size.

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Category 2: Board Structure

Level 3:

- Chairman/CEO functions:
 - Chairman and CEO are separate functions and Chairman assures proper Corporate Governance practices; or,
 - No separation between Chairman/CEO roles, but an independent, external chairs an Independent Directors meetings
- External, independent Directors have been incorporated and are fully operational.
- Board is selected for knowledge, experience, personality and expected-contribution, resulting in very good performance.
- Board size is adequate to ensure effective board performance.
- Board Committees:
 - All required Board Committees are fully integrated, following industry best practices as regards participants; or,
 - The board is performing all the required Committee functions due to its small size.

Level 4:

- Chairman/CEO functions:
 - Chairman and CEO are separate functions and Chairman assures outstanding governance practices are in place; or,
 - There is no separation between Chairman/CEO roles but there is an independent, external, strong lead director, ensuring an excellent level of diverse, constructive opinions at board meetings.
- External-Independent Directors are a majority in the board, including the Chairman's function.
- Board is selected for knowledge, experience, personality and expected contribution – a key performance factor.
- Board size is adequate for excellent board performance. Diversity through external directors is a fact.
- Board Committees:
 - All required Board Committees are fully operational, within the highest levels of excellence in the Industry; or,
 - The Board is performing these functions due to its small size.

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Category 3: Board Procedures

Level 1:

- There is no clear, accepted definition of Board Member Independence.
- Election Terms/Term limits have not been clearly established.
- Mandatory retirement has not been established as a norm, nor is it used as a de-facto standard.
- There is no clear, accepted procedure as regards board compensation.
- Senior Managers and non-Directors are never invited to participate in BOD meetings.
- The Committees/Members/board Function Descriptions have not been established.
- Not all board members can participate in the preparation of agenda items.
- BOD meeting agendas or minutes are not regularly produced or are not available.
- Information for BOD meetings is not produced and distributed to all members in advance to the meetings.
- There is no process for selecting board members or the CEO.
- Directors are not trained according to company needs. There is no introduction program for new Directors.
- There is no evaluation process for the Board, board members, or Committees.

Level 2:

- Even though Board Member Independence has been defined, there are no signs of its implementation.
- Election Terms/Term limits have been established, but are not enforced.
- Mandatory retirement has been established as a norm, but is not implemented consistently.
- There is an accepted policy on board compensation, but it is neither fully utilized nor enforced.
- Board has created Committees/Members Function Descriptions, but they are not used consistently to assess performance.
- Agendas and minutes are produced for each board meeting. Not all BOD members can include items on the Agenda.
- Information on BOD meetings is not always produced and distributed to all members in advance to the meeting.
- There is a process to select board members and CEO, and manage succession, but it is not consistent nor enforced.
- Directors are not fully trained according to company needs.

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Category 3: Board Procedures (contd.)

Level 3:

- Board has a number of Independent Directors, in compliance with its policy and best practice.
- Election Terms and Term Limits have been clearly established and are normally enforced.
- A mandatory retirement age has been established as a norm, and is in use.
- There is a clear and accepted policy on board compensation, which is in use.
- All board functions and committees are defined,, regularly reviewed and used to assess their respective performance.
- Professional management of BOD meetings is consistent. Agendas and minutes are regularly produced for each meeting.
- Information for BOD meetings, containing all relevant information, is provided in advance to the meeting.
- All board members can contribute to the agenda content.
- Directors are trained according to needs and a positive outcome is achieved.

Level 4:

- Board has Independent Directors, in accordance with its policy. This number assures strong independent opinions.
- Election Terms/Term limits have been clearly established and are mandatory.
- A mandatory retirement age has been established as a norm and its application is enforced.
- There is a clear, accepted and competitive policy on board compensation, which is in use and enforced.
- All board functions and committee tasks result in improved board performance.
- Professional management of BOD meetings is consistent. Agendas and minutes are regularly produced for each meeting.
- The quality of the Information provided for board meetings is excellent.
- All board members normally contribute to agenda content.
- Directors are fully trained according to company needs. The outcome is excellent for the Company.

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Category 4: Board & Management

Level 1:

- There is no clear division between Board and management responsibilities in areas such as: budget, planning, strategy, risks, and crisis management.
- There is neither a policy nor a Compensation Committee to manage Senior Management Compensation.
- Board members do not normally meet with Senior Management.
- The CEO is not formally evaluated by the BOD on a regular basis.
- CEO/Senior Management succession is not planned.
- There are no training/development plans for senior management.
- Relevant data related to Company performance is either not complete or is not received by the board on a timely basis.

Level 2:

- Board and Management responsibilities have been clearly defined but not fully implemented, in areas such as: budget, planning, strategy, risks, and crisis management.
- There is a policy or a Compensation Committee to manage Senior Management Compensation, even though it is not fully enforced.
- Non-board members occasionally attend board meetings.
- There is a process through which board evaluates the CEO, but is not used regularly. Quality of evaluation is poor.
- CEO/Senior Management succession is planned, but not 100% enforced.
- There are training/development plans for management, but they are not fully implemented.
- The Company has a Risk assessment (including security) as well as a Crisis Management program, which are not fully functional.
- Relevant data to be used by Board and management has been defined and agreed but is not available on a regular basis.

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Category 4: Board & Management (contd.)

Level 3:

- Board and management responsibilities have been clearly defined, and are fully operational, in areas such as: budget, planning, strategy risks, and crisis management/
- There is a fully enforced policy, or a Compensation Committee, to manage Senior Management Compensation.
- Non-board members attend board meetings as needed.
- There is a process to evaluate the CEO and it is used regularly. Quality of evaluation is very good.
- CEO/Senior Management succession is planned and implemented.
- There are well-implemented training/development plans for management.
- Relevant information used by board and management is defined and agreed, and is available on a regular basis.
- The Company has a complete risk assessment (including security) as well as a crisis management program.

Level 4:

- Board and management responsibilities are clearly defined, fully implemented, and drive excellent results..
- A fully enforced policy, or Compensation Committee, manages all aspects of senior management compensation.
- Non-board members are regularly invited to board meetings.
- There is a standard process to evaluate the CEO, and it is used regularly.
- CEO/Senior Management succession is planned, and rigorously enforced.
- There are complete, state of the art training/development programs for all levels of management.
- Relevant data used by the Board and management is instrumental to the Company's excellent performance in this regard.
- All security issues are addressed by the Board and management regularly, delivering a safe working environment.
- The Company has a complete Risk assessment program, which is regularly updated according to new situations.
- The Company has a crisis Management program, which is fully implemented and includes rehearsals on a regular basis.

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Category 5: Board & Shareholders

Level 1:

- Company information is not disclosed to all shareholders.
- Remuneration of CEO/BOD members is not disclosed.
- Director, Committee, and BOD assessments are not disclosed to shareholders.
- 'One share one vote' is not enforced as a rule.
- Ownership structure is not disclosed to shareholders.
- Compliance with regulations and with the spirit of the law is not disclosed to all shareholders.
- Not all shareholders can participate in the election or dismissal of board members.
- A fair participation of Shareholders in Company profits is not assured, nor is the inherent information transparent.
- Not all shareholders can participate in decisions regarding extraordinary transactions.

Level 2:

- Company information is partially disclosed to all shareholders.
- Remuneration of CEO/BOD members is not disclosed on a regular basis.
- Director, Committee, and BOD assessments are disclosed at the shareholder level, but not on a regular basis.
- 'One share one vote' is the rule, but is not enforced.
- Company information relevant to the Shareholders is produced, but is not available on a regular basis.
- Ownership structure is available.
- Compliance with regulations and with spirit of the law is addressed by board but not entirely disclosed to shareholders.
- The process in place does not ensure the participation of all shareholders in the election or dismissal of board members.
- Shareholders' share of Company profits is not consistently assured, nor is the related information fully transparent.
- Not all shareholders participate regularly in extraordinary transaction decisions.

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Category 5: Board & Shareholders (contd.)

Level 3:

- Company information is fully disclosed to all shareholders.
- Remuneration of CEO/BOD members is fully disclosed.
- Director, Committee, and BOD assessments are disclosed to all shareholders.
- 'One share one vote' is fully enforced as a rule.
- Ownership structure is disclosed to all shareholders.
- Compliance with regulations and spirit of the law is addressed by board and is fully disclosed to shareholders.
- All shareholders can easily participate in the election and dismissal of members of the board.
- Shareholders' fair share of Company profits is a fact. Related information is fully transparent.
- All shareholders have the same opportunity to participate in extraordinary transaction decisions.

Level 4:

- Company information is fully disclosed to all shareholders through an excellent/consistent process.
- Remuneration of CEO/BOD members is fully disclosed.
- Director, Committee, and BOD assessments are proactively disclosed to all shareholders.
- 'One share one vote' is fully enforced as a rule.
- The Company proactively delivers needed/relevant information to all shareholders, on a timely basis.
- Ownership structure is proactively disclosed to all shareholders.
- Compliance with regulations and spirit of the law is regularly addressed by board, and completely disclosed to shareholders.
- All shareholders are invited to participate in the election and dismissal of members of the board.
- The Shareholders' share of Company profits is assured by means of an excellent/transparent information system.
- All shareholders are invited to participate in extraordinary transaction decisions.

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Category 6: Board and Community

Level 1:

- Issues are not fully disclosed to the Government and Community, in compliance with the spirit of the law and regulations.
- There is no formal Company communication process for Institutional Investors.
- There is no professional Company communication process for Customers.
- There is no professional Company communication process for the Press.
- The board is not addressing Community issues.

Level 2:

- There is a process to disclose issues to Government and Community, as demanded by the law, regulations and the spirit of the law, but the latter is not fully implemented.
- There is a process for Company communication to Institutional Investors, but it is not fully implemented yet.
- There is a process for Customer Communication, but it is not fully implemented yet.
- There is a process for Communication to the Press about Company related issues, but it is not fully operational yet.
- The board is addressing Community issues and is starting to produce some positive results in this regard.

Level 3:

- There is a professionally created process to ensure that timely and accurate disclosure is made on all material matters regarding the Corporation, including the financial situation, performance, ownership and governance of the company.
- The board is actively working on Community issues. The Community's evaluation/perception of the Company is very good in this regard.

Level 4:

- There is a professionally created process to ensure that timely and accurate disclosure is made on all material matters regarding the Corporation, including the financial situation, performance, ownership and governance of the company. The quality of implementation is within the best in the industry.
- The board is actively working on Community issues. The Community's perception of the Company is excellent in this regard.

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Category 7: Board Contributions

Level 1:

- Company financial results are not aligned with shareholders'/owners' expectations/needs.
- The Board is not contributing to the Company's competitive access to Capital.
- The Board is not helping the Company to improve its performance indicators.
- The Board is not a factor in generating either Brand value or an Company Image.
- Intangible Capital is not a Board concern.
- Stakeholders' evaluation/perception of the Board is poor.
- The board is not a key factor in generating critical/needed strategies.
- Company contribution to the Community is neither evaluated nor perceived as good enough.

Level 2:

- The Board is proactively aligning needed financial results with shareholders'/owners' expectations/needs; results are still below external performance levels, but the trend is positive.
- The Board is not aware of its role in helping the Company to obtain competitive access to Capital.
- The board is helping the Company to improve its performance indicators, which are not in the desired state yet.
- The board is proactively working on improving Brand value as well as Company Image. Goals have not been met yet.
- The Board is active in generating/preserving the Company's Intellectual Capital value. The first signs of improvement are present.
- Stakeholder' evaluation/perception of the Board is improving, but not at an Industry Standard level.
- Evaluation/Perception of the Company's contribution to the Community is starting to improve.

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Category 7: Board Contributions (contd.)

Level 3:

- Financial Results are consistent with external expectations. The board is recognized as a key factor in obtaining results.
- The Board assists the company in obtaining competitive access to Capital.
- The Company's performance indicators are within accepted industry parameters.
- The Company's Brand value is aligned with Industry standards. Company Image is very good. The Board has been instrumental to this situation.
- The Board is active in generating/preserving the Company's Intellectual Capital value, with very good results.
- Stakeholders' evaluation of the Board is very good.
- Community evaluation/perception of the Company as a whole is very good.

Level 4:

- Financial Results are better than those of Leading Companies in the Industry, and the board is recognized as a key factor in obtaining such results.
- Company access to Capital is within the best in the Industry. Board activity is critical in this regard.
- The Company's performance indicators are among the best in the Industry.
- The Company's Brand value is better than Industry Standards. Company Image is Excellent. The Board has been instrumental to this situation.
- The Board is recognized as a key factor in generating/preserving the Company's Intellectual Capital value. Results are excellent.
- Stakeholders' evaluation of the Board is excellent.
- Community evaluation/perception of the Company as a whole is excellent.
- There are training/development plans for management, which contributes to the excellent results of the Company.

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Choosing Category Relative Weights:

Estimating the Relative Importance of the Category:

Management must determine the relative weight or importance for each of these seven categories. Management must distribute a total of 100 available points across the seven categories in a way that is aligned to the values that are strategically important.

Calculating the Final Organization Score:

The score assigned in each of the seven categories according to the perceived level of maturity (first decided by level and then assigned a point score within the level) is multiplied by the weighting factor to define the total weighted score for the categories. The sum across the seven categories becomes the total score evaluated for the organization (1000 point maximum).



Example of Board Evaluation Matrix

| LEVEL | Scores for LEVEL | Board Mission & Principles | Board Structure | Board Operating Procedures | Board & Management | Board & Shareholders | Board & Community | Board Contributions | |
|-------|------------------|----------------------------|-----------------|----------------------------|--------------------|----------------------|-------------------|---------------------|-----------------------|
| 1 | 0-1 | | | | | | 1 | | |
| 2 | >1 to 3 | | | | 3 | | | | |
| 3 | >3 to 7 | | 7 | 6 | | 5 | | 6 | |
| 4 | >7 to 10 | 10 | | | | | | | |
| | Score | 10 | 7 | 6 | 3 | 5 | 1 | 6 | TOTAL |
| | Factor | 20 | 7 | 7 | 10 | 10 | 6 | 40 | Evaluation (Max.1000) |
| | TOTAL | 200 | 49 | 42 | 30 | 50 | 6 | 240 | 617 |



Taking Action on the Results:

Where should a board take action?

Consider the example – what should management work on first as its priority?

- Category 4: Board and Management (weight 10)
- Category 6: Board and Community (weight 6)

To identify what specific action might be improved, the board must evaluate its answers to the questions which determined its score.

Discussion:

What board performance level is evaluated by this self-assessment?



Current Issues in Governance Quality:

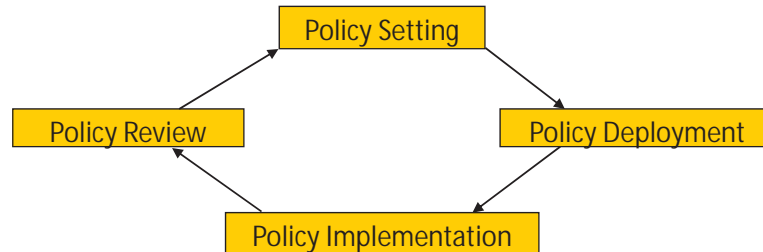
Measurement Integrity is the Basis for Profound Knowledge:

- Summary or aggregated statistics do not give profound knowledge.
- Average performance does not indicate where to improve nor does it tell where best practice may exist.
- If measurements do not have integrity, then management decisions are no better than guesses!
- How complete are your operational performance indicators? How good is your performance measurement system? What trends are detectable in your performance data? How does your performance compare to industry average? How about external benchmark?



Current Issues in Governance Quality:

Policy Deployment as the Approach for Coordinated Action:



- Identifying critical business assumptions and areas of vulnerability (Board)
- Identifying specific opportunities for long-term improvement (Board)
- Establishing business objectives to address the most imperative policies (Board)
- Setting performance improvement goals for the organization (Board/Management)
- Developing change strategies to address business objectives (Management)
- Preparing an annual policy implementation plan for the organization (Management)
- Defining project charters for implementing each change strategy (Management)
- Implementing the change projects (Organization)

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End of today's presentation... quality dialogue continues ...



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