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A Competence Model for Evaluating the Performance of the CEO

A Competence Model for Evaluating the Performance of the CEO

Every organization exists to obtain certain results. This is true for both private and publicly owned business entities as well as for non-profit organizations. It is assumed that a for-profit entity exists to provide a monetary return to its investors. This is the heart of the capitalistic system. Non-profit organizations exist to achieve outcomes related to their stated mission or purpose.

In both situations, the board of directors entrusts the leadership and guidance of the organization to the chief executive officer. The CEO is charged with obtaining the desired outcomes.

One of the Board's Most Important Roles

Selecting and monitoring the performance of the CEO is among the top two or three most important functions of a board. Some of the most costly errors in the history of business can be traced back to glaring errors in judgment made by the board of directors about the CEO. Likewise, some of the best outcomes have been because the board made a wise CEO selection.

Mistakes in the selection of a CEO will always happen regardless of the care given to the process. Unexpected "black swans" can appear that an otherwise good CEO is unprepared to handle. However, too often a board finds themselves in a situation where the CEO clearly is not an outstanding performer yet neither is it obvious to the board exactly what is going on. It is easy to overlook the risk inherent in a troublesome but ambiguous situation, especially if management attempts to keep the board in the dark.

Whatever the reasons, the proper evaluation of the performance of the CEO is something most boards fail to do well.

Two Reasons for this Neglect

There are two reasons boards find themselves in this situation:

- First, the board may not share a common set of expectations for the CEO's performance. That is, they do not work from a common competence model for evaluating the CEO's performance.
- The second reason is that they are woefully unprepared to assess the CEO's performance. They do not have the appropriate tools. Most evaluations, if they are done at all, are amazingly inadequate. The methods used range from gathering unstructured data only from the board members themselves to asking the CEO to provide a self-evaluation for the board's review. It is very rare that a board will cast the net widely and gather objective data that can be compared across responding groups.

So with no accepted competence model and little access to valid and disciplined assessment tools, it is small wonder that boards are extremely handicapped when it comes to monitoring the performance of the CEO.

Compounding this problem are also many social factors. Prime among these is the situation where the CEO is also the Chairman of the Board. This loads the dice in favor of avoiding an objective performance evaluation. Even a strong lead director can find it rather daunting to suggest a thorough evaluation of a CEO who is also Chairman and has probably recruited many or most of the outside directors. Peer pressure works against the board accomplishing an objective evaluation.

The Risk

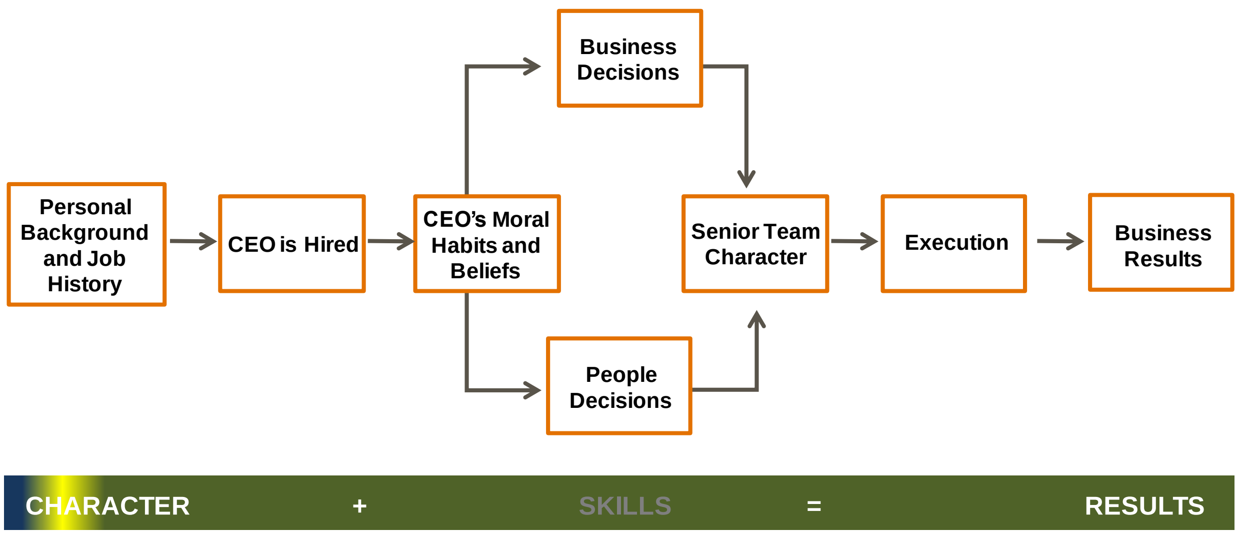
Nevertheless, such social pressures do not reduce each director's fiduciary responsibility or the liability that goes along with being a director. It is not unheard for a widely recognized and successful CEO to end up in the ditch and bring a horde of lawsuits raining down on everyone—including all of the directors. The casualties of the financial collapse of 2008 can attest to this fact.

The CEO Value Chain

Our research is organized around a concept we call the "CEO Value Chain."

Figure 1

The CEO Value Chain

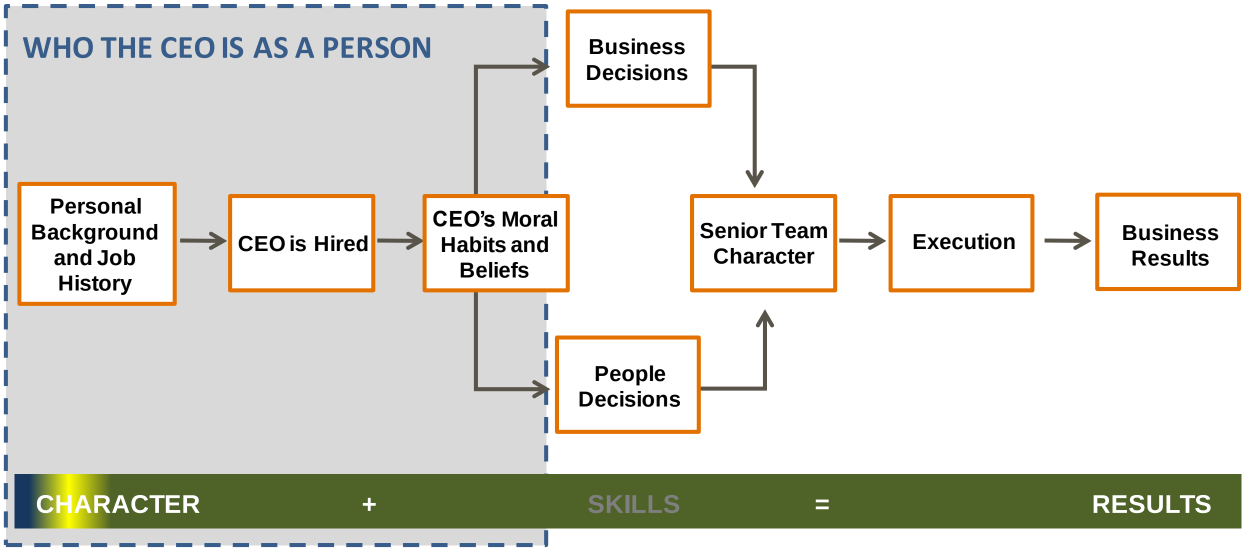


A CEO enters the corner office carrying with him or her personal background experiences and a job history. Some of that will be very useful and some of it may be like a sailboat dragging an anchor. A small anchor can probably be ignored but if a big one is thrown overboard, it can bring a sailboat race to an abrupt ending.

The core of this personal content which in many ways determines a CEO's performance is the unique combination of moral habits and beliefs that motivate and shape how he or she relates to others. We call this the CEO's "character."

Figure 2

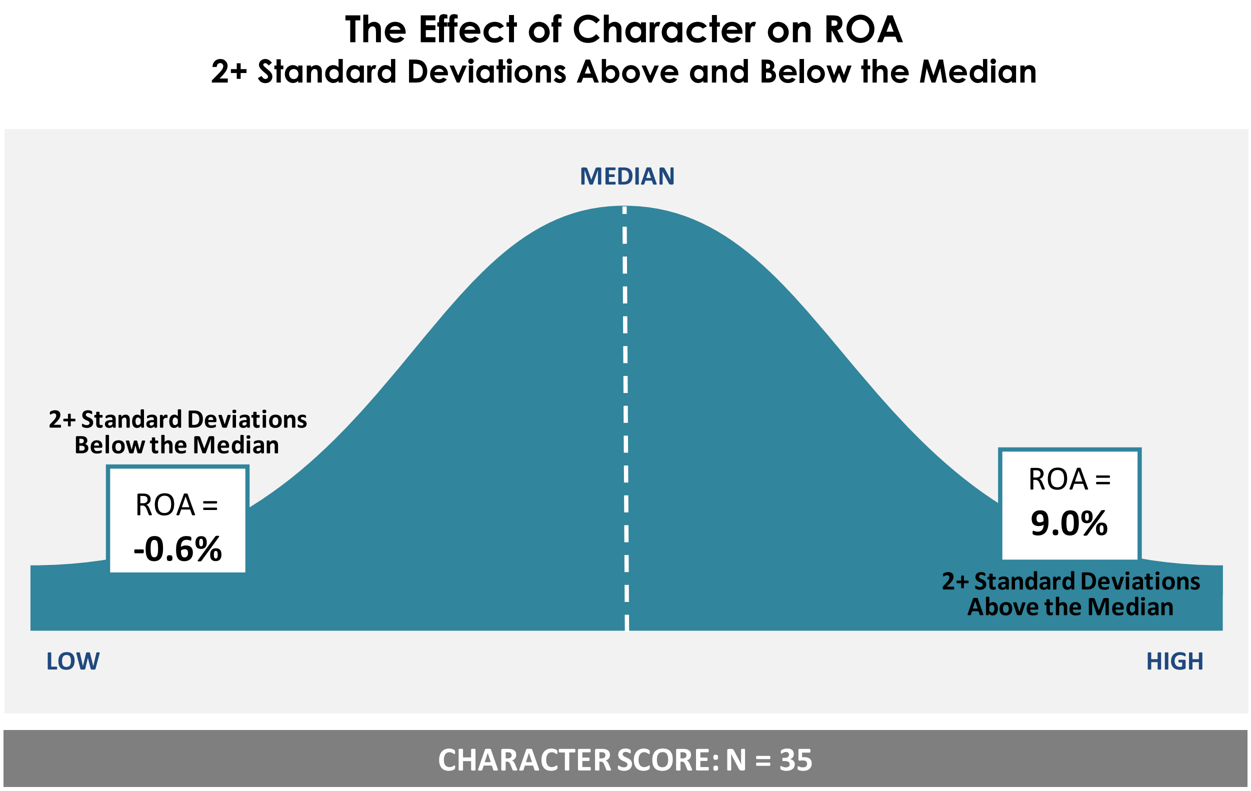
Who the CEO is as a Person—A CEO's Character



Our research [to be reported in ***The Return on Character: Be Good to Be Great*** (Harvard Business Review Press—expected publication in 2014)] makes a persuasive case that "who the CEO is as a person" is just as important as the CEO's skills. We have identified a set of CEOs in our research rated very highly for their character by randomly selected groups of employees. We call them our "Virtuoso" CEOs. Contrasted to these CEOs is another group who are rated very poorly by their employees. We call them the "Self-Focused" CEOs.

Figure 3 shows the impact that the CEO's character can have on hard business results.

Figure 3



The Virtuoso CEOs contribute a return on assets of nine percent will the Self-Focused CEOs erode the asset base.

How We Measure Character

Through our research on 102 CEOs and the observations of over 8,000 employees, we have isolated a set of beliefs and behavioral indicators that serve to separate the highly effective Virtuoso CEOs from the less effective Self-Focused CEOs.

Beliefs

Recent research in the decision sciences has revealed that a CEO's biases and assumptions are very important. These mostly subconscious beliefs influence many of the CEO's most important decisions about people and business challenges. Our research has helped us identify a set of belief statements that exert an influence on a CEO's decisions.

There are four positive beliefs about personal purpose, organizational life and human nature that Virtuoso CEOs routinely demonstrate in their behavior and are not as often demonstrated by the less effective CEOs.

These beliefs are:

1. What drives me or gives me meaning is leaving the world a better place
2. Most people want to be honest, responsible and kind to others
3. All businesses, no matter how large or small, share a responsibility to contribute to the common good
4. All people deserve the same respect, regardless of the size and status of their jobs

In addition, we isolated a list of nine negative beliefs that the Virtuoso CEOs do *not* embrace but which the Self-Focused CEOs often demonstrate with their behavior. These beliefs are:

1. In the final analysis, the only person you can depend on is yourself
2. People have limitations and weaknesses and it is pointless to try and change them
3. Most people have to be closely monitored to make sure they perform
4. When it comes down to it, most people cannot be trusted
5. Meeting quarterly goals is generally wiser than focusing on the long term since there are many unknowns
6. Employees must not be treated to kindly by management or else they will become lazy
7. By generating conflict, one can usually find the truth about a situation
8. I am afraid of change unless I'm in control
9. There is no one in the company who will look out for me – no one to "protect my back"

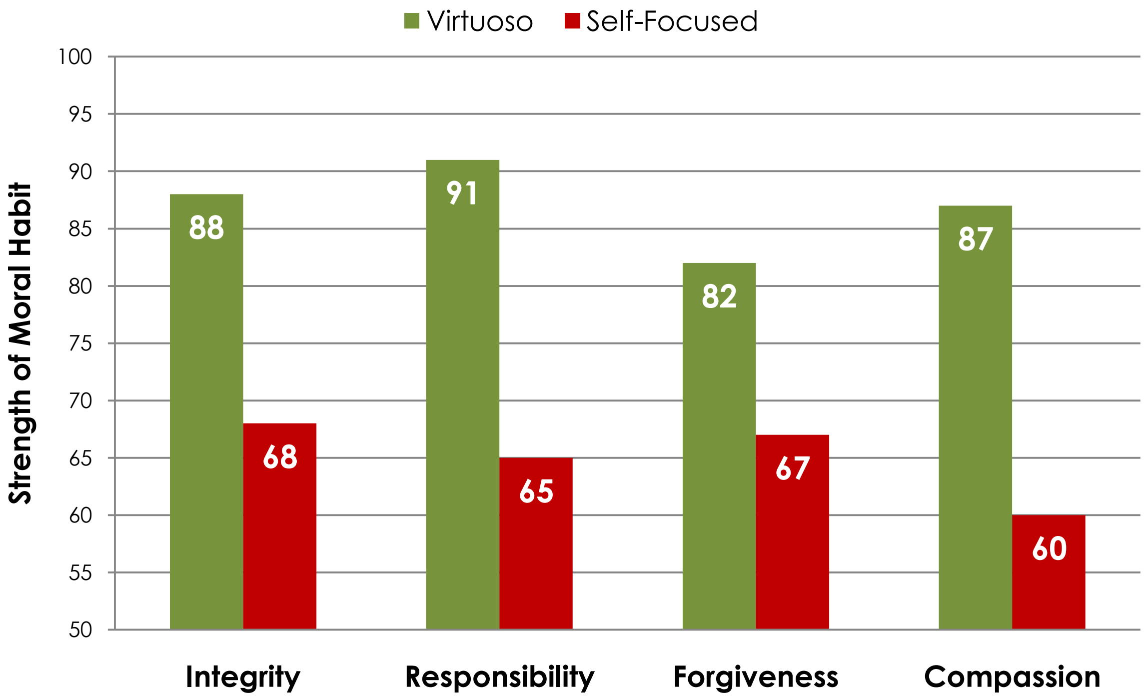
Moral Habits

We identified several behavioral indicators that also serve to separate the highly effective Virtuoso CEOs from the less effective Self-Focused CEOs. These behavioral indicators can be sorted into four moral habits:

1. **Integrity** (Telling the truth, keeping promises, standing up for what's right)
2. **Responsibility** (Owning up to mistakes and accepting the consequences; expressing a concern for the larger common good)
3. **Forgiveness** (Letting go of one's mistakes as well as other's well-intentioned mistakes)
4. **Compassion** (Caring for people as people vs. treating them as "human capital" or "production units.")

One of the surprising findings from our research is how important all four of these moral habits are in order for a CEO to be effective. Telling the truth and owning up to one's own mistakes is not enough. The highly effective CEO must also show forgiveness and compassion. Employees told us repeatedly that if the CEO and senior management don't care for them as people, they won't care about the CEO's vision or the strategic plan.

Figure 4



He demonstrates this moral habit…

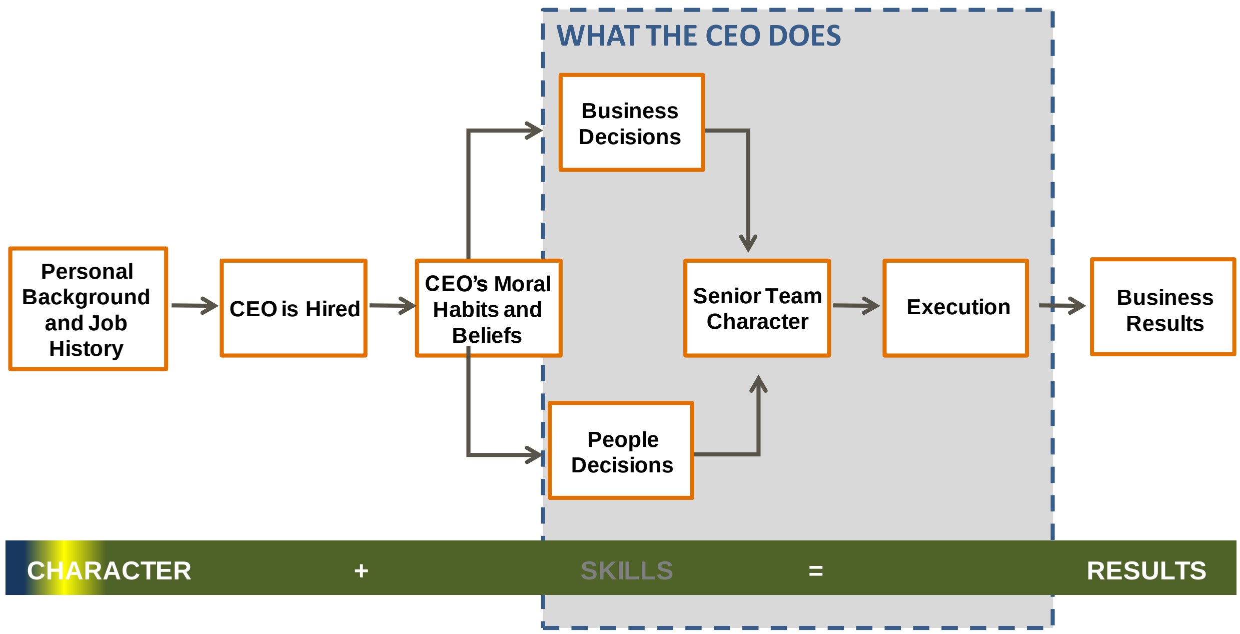
100	=	Always
87.5	=	Almost always
75	=	Frequently
62.5	=	Slightly more than half of the time
50	=	Half of the time (50/50)
37.5	=	Slightly less than half of the time
25	=	Infrequently
12.5	=	Rarely
0	=	Never

What the CEO Does

Depth of character is not enough. Many very fine, principled people could never be effective CEOs because they do not possess the requisite skills.

Figure 5

The CEO Value Chain



There are many books and scholarly articles on the subject of the skills needed to be an effective Chief Executive Officer. We have seen many competence models that are mind-numbing with detail or simply descriptions of vague, un-measureable competences.

Decision Making: A META Skill

From our experience in studying the behavior of CEOs, we have concluded that the core of a CEO's job is to make decisions. Every CEO is called upon to make significant decisions about the direction of the business and equally important decisions about the senior team, the leadership pipeline and the overall workforce. We consider decision making to be a meta-skill. It is a skill that is embedded in all other CEO skill sets. We have isolated eleven behavioral indicators of a disciplined decision making process and eight indicators of a flawed process. Virtuoso CEOs are rated by their direct reports as almost always demonstrating the indicators of a disciplined process and as infrequently demonstrating the indicators of a flawed process.

Selecting and Leading the Senior Team

No CEO accomplishes anything except through the efforts of the senior team. So a second critical skill of the highly effective CEO is the selection and leadership of his or her team. We found by analyzing the data provided by over 8000 employees that the character of the senior team is even more important than the character of the CEO. Workforce engagement levels track closely with the character ratings of the senior team. The higher the trust and confidence in the senior team, the greater the level of workforce engagement. The Virtuoso CEO understands this and gives great attention to selecting and leading the senior team.

Vision, Strategic Focus and Accountability

The highly effective CEO must use his or her time wisely. Even the best senior team needs careful direction. Virtuoso CEOs are rated as providing an inspiring vision along with a targeted strategic focus. The Virtuoso CEOs keep the team and the overall organization focused on a short list of strategic initiatives—typically no more than three or four.

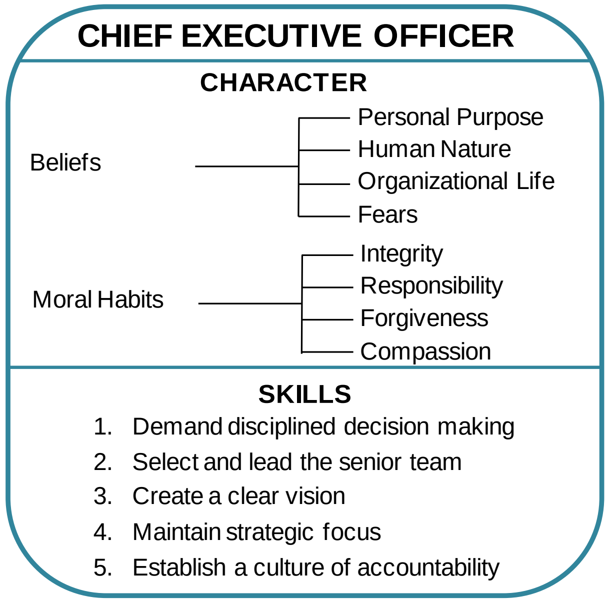
Finally, Virtuoso CEOs do not confuse compassion and accountability. Caring for people as people also means telling them the truth about their successes and failures. Virtuoso CEOs create a culture of no-nonsense accountability. Marginal performers are counseled out or moved into a role that matches their skills.

The Model Summarized

Our research has revealed compelling data that supports this model. Chief Executive Officers, like all human beings, are multi-dimensional and complex. Hundreds of traits, skills and qualities *could* be assessed. Psychological traits. Personality dimensions. Other character habits. And a multitude of other leadership and business skills.

While our model summarized in Figure 6 is quite simple, it is complex enough to describe highly effective CEOs. Each of the character habits and beliefs and the five skill sets are highly predictive of CEO success. Each of these variables is highly correlated with each other and ultimately with hard business metrics such as return on assets (ROA) and workforce engagement. It is our claim that a CEO who is rated highly by a large random sample of employees on all of these dimensions is very likely to also be a highly effective CEO.

Figure 6



Other Measures of CEO Performance

It is not expected that a complete evaluation of a CEO's performance will consist *only* of these character habits, beliefs and critical skills. Other actual business outcomes should be assessed as well. It is the duty of the board, perhaps the audit committee, to establish those additional business outcomes. Many will be unique to the company or at least to the sector.