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Performance Evaluation of the Board of Directors in Listed Companies: A Small State Perspective

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Abstract:

Purpose: *The objectives of this paper are to analyse both individual and overall performance evaluations of the Board of Directors as carried out by Maltese Listed Companies (MLCs) and to assess the importance of such board evaluations to small shareholders.*
Design/Approach/Methodology: *The study was designed around semi-structured interviews with fifteen MLC representatives and seven stockbrokers, as well as questionnaires administered to twenty-nine small shareholders.*
Findings: *The findings indicate that, while Boards of Director evaluations are carried out in MLCs, they lack the necessary formal structures that specify critical evaluation measures. Thus one may infer that those charged with the responsibility of conducting evaluations are not being well determined. By departing from the recommendations of the Maltese Corporate Governance Code on performance evaluations, MLCs have generally opted to resort to an inward and more restricted style of evaluation, doing away with external or independent parties in the process.*
Practical Implications: *Recommendations include the promotion of shareholder interest by enhancing their awareness of the benefits they will stand to gain from the process and by involving them more in the process.*
Originality/Value: *The paper considers possible evaluation measures that may be aimed to enhance both shareholder and public confidence in the exercise and also other ways by which it may be improved. It thus contributes to the literature, as yet scarce, which relates to corporate governance in small states.*

Keywords: *Performance evaluation, corporate governance, board of directors, MLCs.*

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1. Introduction

Corporate Governance has long been associated with the restriction of “opportunism and self interest” that emanate from the agency relationship between shareholders and managers (Saravanamuthu, 2005). Ultimately, this onus rests on the shoulders of the Board of Directors (BoD) as its members are expected to act in the interest of the company. Furthermore, the BoD has the authority to determine the company’s strategic objectives, to provide the necessary leadership to materialise them, to monitor management, and to report to the shareholders on their stewardship (Cadbury Committee, 1992).

The wide capacity of the BoD shows that they play a “critical role in the success of corporations” (Mitchell, 2015). For this reason, directors are bound by duties to safeguard against their possible disloyalty and to address the conflict of interests between directors and shareholders (Ramsay, 1997). Nevertheless, the number of recent business failures and corporate scandals illustrate that the BoD does not always represent the interests of shareholders well (Hanson, 2002; Mullakhmetov *et al.*, 2018). Under these circumstances, the BoD should not only be concerned with the performance of the company and its managers but also its own and one way of doing this is through board evaluations (Kiel and Nicholson, 2005; Morais Pereira and Candeias Bonito Filipe, 2018).

Board evaluations enable boards to scrutinise and reflect on their current performance by incentivising them to acknowledge their strengths and weaknesses, and also the possible opportunities available to improve their performance (Rebeiz, 2016; Humphries 2014). The BoD is a crucial internal control mechanism (Fama, 1980; Jensen, 1983) and is one of the most discussed issues in corporate governance literature (Velayutham, 2013). Additionally, the focal point of most of the corporate governance reforms has been to affirm the importance of the function and performance of the BoD (Gill, 2013; Ujunwa, 2012). Yet surprisingly, very few recent academic papers have touched upon the subject of board evaluations (Agyemang and Castellini, 2015; Rebeiz, 2016; Suryanto *et al.*, 2017).

Various countries have put in place Corporate Governance Codes aimed at encouraging fair dealings and improving in the quality of information disseminated to existing and potential shareholders (Chhillar and Lellapalli, 2015). In Malta, following admission to the Malta Stock Exchange (MSE), Maltese Listed Companies (MLCs) must abide by the Listing Rules as issued by the Listing Authority, which require the adoption of the Corporate Governance Code (CG Code) on a ‘comply-or-explain’ basis (Listing Rules, 2019). The Maltese CG Code is heavily influenced by the developments in the UK and the OECD (Bezzina *et al.*, 2014). The CG Code promotes the adoption of twelve CG principles, one of which being the “Evaluation of the Board’s Performance” (CG Code, p. 10). These principles were drawn up to serve as means to “enhance market integrity and

confidence”, ensure proper transparency in all dealings of the BoD and improve the protection of shareholders (CG code, p. 1).
This paper focuses on Maltese companies listed on the MSE, which are the companies subject to the highest degree of transparency in Malta, and aims:

(a) to analyse the performance evaluation of the BoD carried out by MLCs;
(b) to assess the importance of board evaluations to small shareholders.

The fundamental aim of this study is to add to the limited body of research that has looked into board evaluations from the perspective of a small state, particularly analysing the value derived from board evaluations for directors to small shareholders. This paper explores the ideal structure of board evaluations and also assesses the importance of evaluating directors on an individual basis.

2. Literature Review

2.1 The Need for Board Evaluations

Corporate governance deals with the accountability of those controlling the company to those who have a financial interest in the company. Thus, those in control are “held to answer for performance” (Licht, 2002). This notion of accountability was acclaimed by Andersen (2015) who emphasised that it is “the key concept in corporate governance”. Therefore, changes in corporate governance should strive to make “management more accountable to boards and making boards more accountable to shareholders” (Bosch, 2002; Chariri and Januarti, 2017).

Since the BoD acts as an agent of shareholders and as a principal of management, agency problems may still arise due to conflicts between the objectives of shareholders and those of directors (Velte and Stiglbauer, 2012). This was also emphasised by McIntyre and Murphy (2008) since directors might be inclined to pursue their own interests, and as a result, “firm performance may be no better than if management had been left unsupervised” (McIntyre and Murphy, 2008). In spite of this, most companies evaluate the performance of their managers and staff, yet refrain from evaluating the BoD which is the peak body of the company (Epstein and Roy, 2010). After all, senior management might become more open to and appreciative of its own performance evaluation once the BoD sets the example and undertakes a board evaluation (Rebeiz, 2016). The design of an effective BoD is a continuous process and is facilitated by periodic board evaluations as they necessitate “active involvement from all directors” while also requiring them to “take their duties more seriously” (Rebeiz, 2016). Consequently, it would not be possible for directors to free-ride and simply rely on their name and reputation (Rebeiz, 2016; Suryanto and Thalassinos, 2017).

Furthermore, board evaluations affirm that the directors are fulfilling their roles (Spencer, 2004) and also send the right message to the firm and its stakeholders by demonstrating a high level of responsibility and commitment (ICSI, 2013). The performance evaluation of the BoD is the "most effective tool for positive performance enhancement" (Beatty, 2014) as it helps in identifying skill gaps in the BoD, which in turn enhances the effectiveness of the BoD (Daily and Dalton, 2003) while also nurturing a spirit of unity and cohesiveness among directors (Kolar, 1998; Rebeiz, 2016). Such evaluations also assist in identifying and resolving potential issues before they reach crisis point (Kiel and Nicholson, 2005) and in highlighting areas that otherwise would not be discussed (Kazanjian, 2000; Garratt, 1997).

D'Alessandro (2010) argued that through board evaluations, directors show that they are willing, able and ready to act in the best interests of the company. At the same time, such process provides current shareholders with "peace of mind", while it encourages potential individual and institutional shareholders to invest in companies which undertake board evaluations. One of the duties of non-executive directors is to supervise the actions of the executives. However, the position of the non-executive directors is ill-defined (Jones and Thompson, 2012), and most of the time they are employed on a part-time basis. As a result, they may not have the technical knowledge of executive directors and may also lack the essential information to make informed decisions, hinting that they are not good substitutes for board evaluations.

Ultimately, evaluations of the BoD are "a legitimate expectation of the shareholders" (Bhagat, 2008). However, it is important to point out that large shareholders control the company as their votes can change the composition of the BoD (Butz, 1994). On the other hand, small shareholders lack the professional knowledge (Ross and Crossan, 2013), and have "little power" and "no incentive" to monitor the BoD (Kandel *et al.*, 2011). As a result, "each shareholder will free-ride in the hope that other shareholders will do the monitoring" (Hart, 1995). Thus, the corporate governance framework should protect the small shareholders in order to induce more shareholder confidence (La Porta *et al.*, 1999).

Despite the benefits companies stand to gain from board evaluations, their implementation has been slow (Ingley and Van der Walt, 2002; Heracleous and Luh Luh, 2002) and in some cases, directors even resisted such evaluations mainly due to the belief that such process might mess up the relationship between directors themselves (Kazanjian, 2000), and make directors feel uncomfortable (Kazanjian, 2000; Garratt, 1997). Furthermore, while in theory board evaluations are an excellent tool, in reality there is a "reluctance to pull the trigger on a non-performing director" (Troubh, 2008).

2.2 The Structure of Board Evaluations

2.2.1 Party responsible for board evaluations

Board evaluations can be carried out internally, externally, or else by the BoD itself but facilitated by external evaluators (Osborne, 2008). Internal board evaluations are cost effective and enhance teamwork among directors (Kiel and Nicholson, 2005). The party responsible for such evaluations can be the chairman, the company secretary or the chair of the nomination or corporate governance committee (Behan, 2009). As regards to the Corporate Governance Committee, the Business Roundtable in 2004 emphasised that this committee should consist solely of independent directors and one of its roles should be to oversee the "composition, structure, operation and evaluation" of the BoD. Similarly, the CG Code recommends that board evaluations should be undertaken by "a committee chaired by a non-executive director" which then reports directly to the chairman of the BoD (CG Code, p. 10).

However, the in-house approach is not favoured by shareholders because it makes it difficult to "ascertain the rigour of the process" (Osborne, 2008). In fact, external evaluators usually lead the evaluation process, particularly the feedback procedures, to ensure transparency and objectivity (Garratt, 1997; Kazanjian, 2000; Steinberg, 2000; Humphries, 2014). The involvement of external evaluators enables confidential interviews to be carried out in a way that allows directors to discuss issues they may feel uncomfortable with (Collier, 2004), or as Walton (2014) calls them, "undiscussables".

2.2.2 Criteria included in board evaluations

The criteria for board evaluations usually consist of the size and composition of the BoD; the independence and competence of each director; the performance of the BoD and the chief executive officer; and training and development (Ingley and van der Walt, 2002). Other evaluation criteria are the length and frequency of board meetings (Walker, 1999), and the understanding of the company and the industry it operates in (Sonnenfeld, 2002). These evaluations can also address succession plans and how the BoD communicates with the company's shareholders (Financial Reporting Council, 2011). In contrast, more subjective criteria such as teamwork, and the value that each director is contributing to the BoD can also be included in these evaluations (Dilenschneider, 1996).

Evaluation criteria can also be extracted from the corporate governance codes. For instance, the UK corporate governance code states that the "evaluation of the board should consider the balance of skills, experience, independence and knowledge of the company on the board, its diversity, including gender, how the board works together as a unit, and other factors relevant to its effectiveness" (UK Corporate Governance Code, 2014). The CG code mentions that the evaluation of the board's performance should aim "to ascertain the strength and to address the weaknesses of the board" (CG Code). However, it does not delve into detail with regards to the criteria that should be used by MLCs to evaluate the performance of board.

2.2.3 Communicating the results of board evaluations

Daily and Dalton (2003) stated that the feedback and results of board evaluations should be communicated with the BoD itself, however, only the evaluation process should be communicated with shareholders. In contrast, Kiel and Nicholson (2005)

argued that the evaluation results can be shared with major customers and suppliers to further improve stakeholder relationships.
The CG Code suggests that when it comes to the communication of the results of board evaluations, the chairman of the board should "report to the board and, where appropriate, to the Annual General Meeting". Furthermore, the CG Code also stipulates that the "extent to which the self-evaluation of the board has led to any material changes in the company's governance structures and organisation" should be disclosed in the annual report (CG Code, p. 10).

2.3 Individual Director Evaluations

Although the majority of performance evaluations concentrate on the BoD as a whole, there are also individual director evaluations. Humphries (2014) argued that individual director evaluations are important as the challenges with respect to the effectiveness of the BoD emanate from the competencies of the individual directors, and therefore such evaluations are capable of providing better and more immediate results. Daly (2008) supported individual director evaluations by arguing that board evaluations fail to identify non-performing directors.

However, Tricker (1999) argued that in some countries, individual director evaluations are deemed to be inappropriate because the BoD is considered to be a team. Furthermore, individual director evaluations are a much more sensitive exercise (Vennat, 1995) and uniform criteria may be unsuitable to evaluate the contributions of every director (Heracleous and Luh Luh, 2002). For these reasons, Kiel and Nicholson (2005) maintained that consensus must be reached prior to introducing individual director evaluations in order to avoid serious conflict within the BoD. Additionally, Ingley and van der Walt (2002) recommended that companies should start off with board evaluations and then introduce individual director evaluations.

With regards to the feedback and results, Daily and Dalton (2003) explained that feedback specific to individual directors should be restricted to one-on-one sessions between the director and the Chairman of the BoD. This encourages "more accurate and honest feedback throughout the process", while at the same time respects "the confidentiality of the process and the individual's integrity" (Kiel and Nicholson, 2005). In addition to evaluating individual directors, the Business Roundtable in 2004 argued that these evaluations should be connected with the nomination process. In fact, it recommended evaluations of individual potential directors prior to their nomination. In spite of the benefits linked to the board evaluation, the CG Code fails to make reference thereto instead focuses solely on the annual evaluation of the board and of its committees (CG Code, p. 10).

2.4 Small Shareholders

Baldacchino *et al.* (2016) argued that most of the small shareholders do not actively participate in AGMs. This low participation of small shareholders in AGMs is mainly coming from poor attendance from the small shareholders due to their lack of financial knowledge, and also due to the fact that small shareholders consider their rights to be rather weak, and therefore AGMs are merely a box-ticking exercise for them. Baldacchino *et al.* (2016) further explained that the rights of small shareholders should be enhanced to improve this situation. One way of doing this is by making sure that communication with small shareholders is “clear and effective” (Baldacchino *et al.*, 2016). Better communication of meaningful information with small shareholders would help to transform the AGM from a box-ticking exercise “focusing on the fulfilment of the financial reporting legal requirements to one with meaningful and potentially far-reaching interactive discussions” (Baldacchino *et al.*, 2016).

3. Research Methodology

Empirical data was derived using a mixed methodology approach and from three different sources: 1) interviews with MLCs, 2) interviews with stockbrokers, and 3) a questionnaire circulated among small shareholders. This methodology enabled the analysis of both the internal views made by the companies and also the external views made by the stockbrokers and small shareholders.

The first group of semi-structured interviews was carried out with directors and company secretaries of fifteen companies which have their equity listed on the Malta Stock Exchange. The aim of these interviews was to determine whether these companies evaluate the performance of their BoD and also to establish the structure of such evaluations and the reasons thereof.

A second set of interview questions targeting seven stockbrokers was formulated to ensure that the study considers both sides of the spectrum. These interviews focused on the ideal structure of board evaluations and the reasons behind evaluating the performance of the BoD according to the brokers.

An online questionnaire utilising a five point Likert scale where the responses could range from Strongly Disagree (1) to Strongly Agree (5) was also designed and circulated among small shareholders who were members of the Malta Association of Small Shareholders. A total of twenty-nine responses were received which enabled us to understand the value given to board evaluations by small shareholders and the ideal structure of these evaluations.

The inclusion of close-ended questions enabled the use of descriptive statistics through the Statistical Package for Social Scientists (SPSS). To check whether the responses differed among the three respondent groups (MLCs, stockbrokers and small shareholders), the Chi-squared test was used in cases of nominal scales and the Kruskal Wallis was used in cases of ordinal scales. Furthermore, the Friedman test was used to compare the mean rating scores provided by each respondent group to a number of related statements.

4. Findings and Discussion

4.1 MLCs Evaluation of the BoD

Prior to analysing the board evaluation process within MLCs, it was first necessary to determine how many of them carried out board evaluations. When the fifteen MLC representatives were asked whether they carried out board evaluations, a slight majority of 54% respondents claimed that they evaluated the board in a formal manner, while the remaining 46% stated that board evaluations were not carried out.

4.1.1 Reasons for evaluating the BoD

The MLC representatives that carried out board evaluations, along with the stockbrokers and small shareholders, where presented with a list of thirteen possible reasons. The MLC representatives strongly agreed that board evaluations should be carried out to demonstrate a high level of responsibility (Md = 5.00), to ensure that the board is fulfilling its role (Md = 4.00) and to improve the performance of the board of directors (Md = 4.00).

Stockbrokers and small shareholders also agreed that (Md = 4.00) board evaluations should be carried out to address conflicts of interests between directors and shareholders, and ensure accountability to shareholders. On the other hand, MLC representatives neither agreed nor disagreed about this reasoning (Md = 3.00), resulting in a statistically significant difference ($p<0.05$). They argued that conflict of interest is not addressed through board evaluations, but through the audit committee or specific conflicts of interest policies.

Furthermore, stockbrokers and small shareholders neither agreed nor disagreed when asked whether board evaluations are necessary due to the fact that non-executive directors do not provide sufficient supervision on the other directors (Md = 3). Two stockbrokers claimed that non-executive directors are usually ineffective as they are a minority on the board and usually foreign and too detached from the company. In contrast, MLC representatives disagreed with this reasoning (Md = 2), resulting in a statistically significant difference ($p<0.05$). The MLC representatives claimed that board evaluations are not carried out because they make directors feel uncomfortable (Md = 4) and also because there is a reluctance to confront a non-performing director (Md = 4).

4.1.2 Importance of board evaluations

When asked whether shareholders look at board evaluations before making investment decisions, 93% of the fifteen MLC representatives claimed that shareholders simply focus on financials, mostly dividends and share prices. Two respondents further commented that small shareholders are either not educated enough to check the annual report for board evaluations, or else do not even know such evaluations exist. Interestingly, one of these respondents attributed this cause to the fact that shareholding is too dispersed in Malta and therefore the level of influence each shareholder can exert is too small for it to warrant such shareholder attention and activism. As for the stockbrokers, 14% declared that they refer to board evaluations, with one stockbroker recalling a case of foreign investment where the firm asked for board evaluations as part of the due diligence process. Comparatively, 32% of the small shareholders stated that they check board evaluations prior to making investment decisions.

4.2 Structure of Board Evaluations

4.2.1 Party responsible for the evaluation process

The MLC representatives that carried out board evaluations were asked to identify the party responsible for the board evaluation process. 63% of the respondents declared that this was the responsibility of the company secretary while 25% explained that the evaluation was carried out by the company secretary in liaison with the chairman. On the other hand, 12% of the companies stated that most of the tasks with respect of the board evaluation process were carried out by the chairman of the audit committee.

A similar question was asked to the stockbrokers to determine who should be responsible for board evaluations. The stockbrokers mostly agreed that board evaluations should be carried out internally but facilitated by external evaluators (Md = 4.57). Two stockbrokers emphasised that companies should appoint a corporate governance committee composed of both internal and external people and such committee should be shouldered with the responsibility of evaluating the board. Two stockbrokers argued that an external consultant should be involved in this process to have an independent and outside view on the matter, whereas another broker explained that an external consultant would be particularly helpful if the company is introducing board evaluations for the first time.

In the case of internal evaluations, the stockbrokers claimed that such responsibility should be borne by the chairman of the corporate governance committee (Md = 2.71), followed by the company secretary (Md = 2.43), the chairman of the board (Md = 2.43), and finally the chairman of the nominations committee (Md = 2.00). At the same time, two brokers proposed that an independent body, such as the regulator or an ombudsman on corporate governance, should formulate guidelines on the evaluation criteria. A similar question was asked to small shareholders to establish whether board evaluations should be carried out internally or externally and the 83% of the small shareholders agreed that such evaluations should be carried out by an external party.

4.2.2 Evaluation criteria used by MLCs in measuring board performance

Each board evaluation contains criteria on which the board is evaluated. Hence, the representatives of MLCs that carried out board evaluations were asked to identify the respective criteria included in their board evaluations. Additionally, stockbrokers and small shareholders were asked to give a rating to these evaluation criteria.

The performance evaluation measures that were given the highest mean rating score by MLCs were ‘competence’ (Md = 4.68), ‘experience’ (Md = 4.61), ‘diligence’ (Md = 4.52), ‘independence’ (Md = 4.45) and ‘ethics’ (Md= 4.32). In fact, the majority of MLCs (75%) included competence and experience measures when evaluating the performance of their BoDs. Stockbrokers and small shareholders also strongly agreed that the performance evaluation should assess competence and the experience of the board. In contrast, the measure ‘structure, length and frequency of board meetings’ (Md = 3.42) has the smallest mean rating score, and yet it was still included in the board evaluations of all MLCs. When asked who answers the evaluation questions and therefore provides information on the board and the aforementioned evaluation criteria, all MLC representatives stated that this was done by the directors themselves. In addition, 25% of the MLCs also claimed that regular attendees of board meetings were also asked to contribute to the board evaluation.

As for the stockbrokers, most of them strongly agreed that such information should be provided by the directors themselves (Md = 4.14), followed by senior management (Md = 2.71) and the Chief Executive Officer (Md = 2.57). On the other hand, brokers did not agree that such information should be provided by employees (Md = 2.29), stakeholder representatives such as customers and suppliers (Md = 2.29).

4.2.3 Communicating the process and results of performance evaluations

Another key component of board evaluation is the communication of its process and results. When asked to whom the board evaluation process was communicated, all MLC representatives stated that such process is made public through the corporate governance statement. As for the stockbrokers, they all agreed that the board evaluation process should be communicated to the board itself, to individual directors and also to the company shareholders. Furthermore, 57% of the stockbrokers also highlighted that such process should also be communicated to major customers and suppliers.

Correspondingly, when small shareholders were asked whether they prefer to be informed about the board evaluation process, the majority (72%) responded in the affirmative. When it comes to the communication of the board evaluation results, all MLC representatives stated that the results were only communicated to the board as a whole. Additionally, 63% of the companies also clarified that the results that the board has access to are anonymous and therefore there is no way to trace the responses to the respondent. Therefore, none of the MLCs communicated the results to the shareholders or customers and suppliers, however, one company pointed out that in the prior year the external auditors extracted some information from the results of the evaluation.

All stockbrokers were of the view that board evaluation results should be communicated to the board as a whole, to individual directors and also to the shareholders. Coupled with this, 71% of them also agreed that the evaluation results should be communicated to major customers and suppliers. One of the stockbrokers remarked that the process and the results go "hand in hand" and it would be worthless to know one without the other. When asked how the board evaluation results are communicated, all MLC representatives highlighted that a discussion on the results was always an agenda item during the following board meeting. Thus, none of the MLCs communicated the results of the evaluations through company announcements, the annual report, the company's website or the annual general meeting.

Stockbrokers were asked a similar question and they all agreed that there should be both a board meeting and a meeting with individual directors to discuss the evaluation results. Additionally, the stockbrokers argued that the results should be communicated at the annual general meeting (86%), published in the annual report (71%), made available on the company's website (29%), and communicated through a company announcement (14%). Interestingly, one of the stockbrokers maintained that there is no need to make the results of the board evaluation public, as long as the shareholders have access to them upon request. As for the small shareholders, most of them agreed to be informed on the results at the annual general meeting (72%), followed by a company announcement (56%), published in the annual report (48%) and made available on the company's website (40%).

4.3 Individual Director Evaluations and its Extend in MLCs

In analysing individual director evaluations, it was critical to determine the number of MLCs that evaluated their board members on an individual basis. When asked whether they carried out individual director evaluations, 40% of the MLCs confirmed this evaluation.

4.3.1 Evaluation criteria used by MLCs in evaluating the performance of individual directors

Similarly to board evaluations, individual director evaluations contain criteria upon which the performance of the directors is evaluated. For this reason, the representatives of the Maltese companies that carried out individual director evaluations were asked to identify the respective criteria included in such evaluations. Correspondingly, stockbrokers and small shareholders were asked to give a rating to these evaluation criteria. Stockbrokers and small shareholders strongly agreed that individual director evaluations should assess the 'experience' (Md = 4.55), 'competence' (Md = 4.52) and 'independence' (Md = 4.52) of the individual directors. In spite of this, only 33% of the MLCs included these three measures in their individual director evaluations.

On the other hand, stockbrokers and small shareholders gave the lowest rating score to the measure ‘bad contributions made by the director’ (Md = 3.71). MLCs were of the same opinion since none of them included this measure in their evaluations. 42.8% of the stockbrokers highlighted that individual director evaluations should not distinguish between good and bad contributions made by directors as they are subjective and difficult to judge. Furthermore, these stockbrokers explained that individual director evaluations should focus on contributions in general to ensure that directors are not silent during board meetings. With regards to these criteria, the difference across the ratings given by stockbrokers and small shareholders was not statistically significant ($p>0.05$).

4.3.2 Distinction between board evaluations and individual director evaluations

The MLCs that evaluated directors on an individual basis were asked whether they made a distinction between individual director evaluations and board evaluations. 83.3% of these companies pointed out that the individual director evaluations formed part of the board evaluations questionnaire. The same companies also declared that these individual evaluations were self-evaluations by the director himself. Furthermore, 50% of these companies emphasised that the individual director evaluations constituted a very small part of the whole evaluation.

Interestingly, 16.7% of the MLCs did not carry out board evaluations but evaluated all the directors on an individual basis. These companies stated that every director evaluated the performance of each and every director through a questionnaire. Furthermore, the results of these evaluations were only accessible by the chairman of the board, who then held individual meetings with the directors to address any weaknesses identified. The stockbrokers were asked on the way individual director evaluations should be undertaken and they agreed (Md = 4.29) that individual director evaluations should be carried out internally but facilitated by external evaluators. In contrast, stockbrokers strongly disagreed (Md = 1.43) with having directors evaluating themselves.

Stockbrokers also commented about the differences between evaluating the board as a whole and evaluating directors on an individual basis, particularly when it comes to the communication of the results. All stockbrokers stated that the results of the individual director evaluations should be communicated to the respective director, followed by shareholders (85.7%), major customers and suppliers (71.4%) and the board as a whole (42.9%). Additionally, 28.6% of the stockbrokers emphasised that “it is not prudent to name and shame in public” unless in cases of significant failures or issues that go against the law. However, half of these stockbrokers later remarked that ultimately the shareholders are the ones investing the money and therefore they should know whether a particular director is performing or not.

5. Discussion

5.1 Board Evaluations

The board of directors is the supreme body of a listed company and is appointed to act on behalf of the shareholders. In fact, this study showed that MLCs welcomed the idea of evaluating the performance of the board, and the research findings indicated that a good number of them carried out these evaluations. This shows that board evaluations are viewed as relevant and important, conforming with the views of Beatty (2014).

5.1.1 What do directors think of bord evaluations? Are they useful or will they cause more harm?

Directors refrain from evaluating the board since it makes them feel uncomfortable. This originates from the fact that the evaluations were all self-evaluations by the board itself. Additionally, there is a reluctance to confront a non-performing director, particularly in a small state like Malta where everyone knows each other. Confronting a non-performing director could be even more challenging if there are no performance evaluations in place. Directors also expressed their lack of motivation in carrying out board evaluations and regarded them as a burden. Being the highest-ranking authority in a listed company, the board has to ensure that it fulfilling its role in an effective manner. This study indicated that according to MLC representatives, board evaluations are not crucial as audit committees and the conflict of interest policies already attended to their purpose. It is to be noted that the strength of the board depends heavily on the underlying strength of its committees, thus significantly diluting the power of the board.

The study shows that there are differing views between those who are being evaluated and those who are considered to be independent of the companies. As may be anticipated, the biased opinion expressed by MLC representatives showed that the controls currently in place are sufficient, while the independent view of the stockbrokers and small shareholders brought attention to the need for improved board evaluations and increased scrutiny.

5.1.2 How should board evaluations be structured to ensure that they are beneficial for all the parties involved?

A good number of MLCs are evaluating their boards. Nonetheless, this does not necessarily mean that such board evaluations are in fact effective. The effectiveness of board evaluations revolves around two things: who carries them out; and how they are carried out. For this reason, respondents had diverging views on the structure of these evaluations, leading one to ponder on such matter.

5.1.3. Who should be the party responsible for board evaluations?

MLCs opted to assign the authority of the board evaluation process to the company secretary. To this effect, MLCs eliminated the possibility of including external evaluators to assist in these evaluations. In contrast, the stockbrokers acclaimed the idea of having a corporate governance committee, which in turn would enable the board evaluation to be part of its domain. However, it is critical that members of this committee are not involved in any way with the management of the company since having the management involved in the evaluation and appointment of directors would give rise to conflicts of interest and end up hindering the effectiveness of these evaluations. Thus, this committee could be composed of internal people, particularly non-executive directors, and also external people, such as the external auditor or an external consultant or adviser. The involvement of external evaluators or independent directors in this committee would induce more confidence of shareholders in the way the company is to be taken forward strategically.

A more radical solution can be adopted when it comes to board evaluations. An ombudsman on corporate governance can be established, who will be, among other things, in charge of leading the evaluation process of all the MLCs. This would further enhance the objectivity and independence of the evaluation process as it would be completely taken out of the domain of the companies, Such a process would not permit the board to exert any kind of influence on the evaluation process and therefore, the board would not be able to use the evaluation to sanitise its own position.

5.1.4 Which criteria should be included in board evaluations?

It was revealed that the criteria that the board evaluations should mostly focus on comprise competence, experience, diligence, independence and ethics. This means that should these criteria be included in the board's performance evaluation principle of the corporate governance codes, it would further increase the harmonisation among all the MLCs with respect to the contents of the performance evaluations.

5.1.5. To whom should the board evaluation results be communicated to?

This study also showed that MLCs only communicate the process of the evaluation to the shareholders and this is done through the annual report. Furthermore, none of the MLCs ever reported anything on the performance evaluations at the annual general meeting, and none of them ever disclosed any material changes resulting from these evaluations in the annual report. Under these circumstances the involvement of the shareholders is continuously being restricted.

One can logically deduce that the board does not evaluate its performance for the benefit of shareholders. In fact, according to the MLC representatives, the two principal objectives of board evaluations are to plan training for directors and to improve the performance of the directors. Without any doubt, these reasons show that the MLCs are carrying out these evaluations to find ways and means to strengthen their current BoD rather than to criticise it or change its composition and structure.

On the other hand, the stockbrokers and the small shareholders strongly believe and expect that board evaluations should be performed to provide peace of mind to the shareholders as the owners of the company. Unfortunately, this purpose is not being achieved due to the lack of communication between the MLCs and shareholders. In other words, if the evaluation results remain within the boardroom, there is no way for shareholders to directly benefit from these evaluations. Clearly, there is room for improvement when it comes to communication between MLCs and shareholders and the ideal communication channel would be the annual general meeting as this is the only occasion where shareholders meet directors face to face. Transparent reporting at the annual general meeting would give the shareholders the opportunity to analyse and gauge the results of the board evaluation process. This would give rise to a forum where directors would explain to shareholders the areas in which they are lacking as a board and would also present proposals on how they plan to address these limitations and better their performance. This would enable the shareholders to question the board on the evaluation results and communicate more with the directors themselves who are the ones in charge of running their company. This would strengthen the relationship between the shareholders and the directors and build more trust between both parties.

The lack of strong institutional investors in Malta, who act as a check on the BoD, shows that the key for good corporate governance are the shareholders at the AGM. Nevertheless, Baldacchino *et al.* (2016) argued that the low participation of shareholders during the AGM is rendering this forum ineffective. With this in mind, one may ask, do shareholders really value the importance of board evaluations?

5.1.6. Do shareholders value performance evaluations?

The board evaluation is the only way for shareholders, mostly the small shareholders, to get a glimpse of what happens in the boardroom. This is even more significant in the case of MLCs as most of the shareholding is fragmented and therefore small shareholders are not able to directly appoint their own representatives on the board. Nonetheless, the main issue with this situation is that although the study revealed that small shareholders know about board evaluations, they do not make reference to them, neither before investing, nor when deciding whether to keep or sell their shares. Considering the fact that shareholders have very limited access to knowledge and information on MLCs, one may ask, why do shareholders refrain from utilising the information they have available?

The reasons for this are various. First of all, according to MLC representatives and stockbrokers, lack of knowledge is the key reason why small shareholders do not refer to board evaluations. The situation stands to improve through associations such as the Malta Association of Small Shareholders. In fact, some MLCs are even holding meetings with this association to further increase and improve the communication with their shareholders. Secondly, small shareholders might not be utilising these evaluations because of their uncaring attitude. This apathy of small shareholders may be due to their low interest, low involvement and low influence.

This has led small shareholders to simply focus and concentrate on the dividends and share prices. Thirdly, small shareholders might not be making use of these performance evaluations because MLCs do not disclose the results of these evaluations. Simply knowing how the evaluation process is carried out does not give a lot of information to the small shareholders to make use of when making investment decisions. Therefore, this restricted access of information is forcing shareholders to disregard the performance evaluations altogether.

5.2 Individual Director Evaluations

5.2.1 Are individual director evaluations useful?

When shifting focus from board evaluations to individual director evaluations, this study showed that small shareholders value the usefulness of individual director evaluations since they are the only way for them to know how much each director has contributed. Furthermore, individual director evaluations eliminate any 'gloss' appointments since they do not tolerate directors sitting on a board simply for the retainer. Individual director evaluations are beneficial mainly due to the fact that, in comparison with board evaluations, they address the weaknesses identified in a more direct and prompt manner since they pinpoint and detect an individual director who is not performing. Under these circumstances, both evaluations complement each other as they enable a lack of performance on all binaries to be identified and catered for.

5.2.2 What are the problems with individual director evaluations? Why do MLCs find it difficult to evaluate directors on an individual basis?

Although there are benefits to individual director evaluations, MLCs have been quite slow in implementing them mainly because the board is considered to be a team and is collectively responsible. As a result, it is assumed that board evaluations are sufficient and although every director has a particular role to fulfil, there might not be a necessity to evaluate the contributions made by each and every director. Another problem of the individual director evaluations carried out by MLCs is the fact that they are mostly self-evaluations by the director himself, thus giving way for subjectivity which renders the whole process ineffective. The fundamental problem of individual director evaluations in Malta is that it is culturally difficult to carry out performance evaluations internally. This cultural trait is particularly predominant in a small state like Malta; as everyone knows each other and most of the boards consist of the same people due to multiple directorships. Furthermore, internal evaluations make directors feel awkward and bring about the risk of having collusions between directors themselves.

Therefore, while the involvement of external evaluators is recommended for board evaluations, this requisite is even more profound when conducting individual director evaluations. In the UK, 'The Institute of Chartered Secretaries and Administrators' offers a service to facilitate evaluations of directors. However, in the case of small countries like Malta, external evaluators can be auditors, lawyers or anyone who specialises in corporate governance.

Moreover, another problem of individual director evaluations is that the law grants the shareholders the right and ability to directly appoint directors, and does not give the company the right to refuse these appointments. Therefore, directors will remain on the board if the shareholders want them there, irrespective of the results of the individual director evaluations. Therefore as long as there is no way to enforce the results coming out of the individual director evaluations, listed companies will continue to put them on hold.

5.2.3 Ideal structure of individual director evaluations

5.2.3.1 Should individual director evaluations be tied to the nomination process?

One of the main drawbacks of the individual director evaluation is that companies do not have a basis on which to enforce its results. This hinders the effectiveness of individual director evaluations and one plausible way to mitigate this drawback is to amalgamate and combine the evaluation process with the nomination process.

Through this amalgamation, companies would implement a screening process prior to the appointment of directors to determine whether the candidates seeking election are competent or not. Then shareholders would choose the directors from the list of competent candidates to ensure that they retain the final say on who becomes a director. Obviously, shareholders would still be able to nominate directors, however, such directors would have to be subject to the same screening process. Such implementation would further enhance the effectiveness of the individual director evaluations since the results of the evaluation would then be compared with those of the screening process. Furthermore, by having both a screening process and an evaluation of directors, the company would be able to identify those candidates that are most suitable and determine the areas in which the board is lacking.

5.2.3.2 Should the results of individual director evaluations be communicated to shareholders? What is the ideal communication medium that should be used in such situation?

The sensitivity of individual director evaluations calls for prudence when it comes to the communication of the results emanating from these evaluations. In fact, all the respondents of this study were reluctant to name and shame in public. This is similar to the findings of Kiel and Nicholson (2005), which showed that the disclosure of results should respect the integrity of the directors. Nonetheless, the respondents still acknowledged the need for such results, or at least a summary report, to be communicated to the shareholders.

6. Conclusions, Limitations and Recomendations

In this study we have identified that, while a good number of MLCs performed board evaluations, very few have embraced the concept of having a formal structure shouldered with the responsibility of evaluating the performance of the board, this making it difficult to identify how the performance of the board is evaluated and who performs such evaluation. The study showed that key measures upon which performance evaluationstake place are competence, experience, diligence, independence and ethics, thus meriting due consideration as to whether these should be included in the CG Code. Moreover, it was noted that MLCs are not involving shareholders in any of the stages of the evaluation process. This lack of communication thus hinders the shareholder ability to gain a proper understanding the evaluation process and substantially limits the benefits they stand to gain from performance evaluation of both the board and its individual members. Furthermore, it was identified that MLCs have no incentive to carry out individual director evaluations unless these are tied to the nomination process since the shareholders still reserve the absolute right to appoint directors irrespective of the outcome of the individual director evaluations.

One of the main limitations noted is that the Maltese market lacks large institutional investors that can monitor and influence the BoD. As a result, shareholding of MLCs is usually made up of a few major shareholders, with the remaining shareholding being highly fragmented and dispersed among small shareholders. A key recommendation which emanates from this study is to broaden further the role of the MFSA or else establish an Ombudsman on CG which would provide guidelines on how to carry out performance evaluations of both the board and individual directors. One of the roles of such an authority would also be to educate the small shareholders to address their apathy.

The MFSA could also be entrusted with restructuring the board’s performance evaluation principle. Such restructuring would include the recommended measures to be used in these evaluations and also the recommended channels of communication with shareholders when it comes to the results of these evaluations. The MFSA would then be able to carry out a more thorough review of the non-compliance section of the CGS issued by the MLCs. This would increase the compliance rates or at the very least lead to better reasons for non-compliance.

On a concluding note, in a small state like Malta, companies need to understand and consider the importance of communicating the performance evaluation of the board of directors to small shareholders. Furthermore, cultural traits prevalent in a small state, particularly with respect to the evaluation of individual directors in the context of an environment where names and familiar and easily recognisable, pose more difficulty in enhancing director performance evaluations and their transparency thereto.

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