SEPARATING THE ROLES OF CEO AND CHAIRPERSON

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INTRODUCTION
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The very first topic selected for the Center for Corporate Excellence for debate at its first full forum was the question of whether the positions of Chief Executive Officer and Chairperson of the Board should be separated.

The Center came down very clearly on the affirmative position on this issue although the debate was quite robust. Since then, the trend in corporate America has been consistent with the Center’s position. In a recent survey by the National Association of Corporate Directors between 67% and 89% of the respondents agreed that these two positions should be separated. And it appears from a number of studies that about of all public corporation’s boards have now achieved such a separation.

While this marks significant progress, there still remains the other 50%. The principles and practices noted in this position paper continue to offer a solid argument for the conversion of this remaining . The Institute for Enterprise Ethics fully supports and endorses the recommendations put forth in this paper.

THE OPENING PAPER

Dr. David Nygren presented the position paper prepared for the Forum by Mercer-Delta Consulting, a leading consulting firm specializing in organizational development and corporate governance. Dr. Nygren noted that a 2003 Conference Board Blue Ribbon commission strongly recommending the split of the two positions. However, this recommendation was not unanimously supported and was, in fact, opposed by some well-respected members of the Commission. In addition, Dr. Nygren noted that although close to 50 shareholder proposals for splitting the roles were pending as of May 2004, such proposals have received scant shareholder support by even the largest and most respected corporations.

One of the conditions often cited in favor of splitting the CEO and Chairperson roles is the fact that an overwhelming proportion of corporations in both the United Kingdom and Canada utilize a split role structure. This situation was substantially influenced by the 1992 U.K. Cadbury Code of Best Practices which required companies to split the roles or to explain their decision to not do so. Other arguments cited in favor of the split structure included:

• Adequate oversight requires independence of perspective by the board
• A split structure distributes (or balances) the workload of the two top jobs
• Having two perspectives on important issues is better than just one
• Shareholders are demanding director independence
• The split structure is becoming an explicit investment rating criterion.
On the other hand, the Mercer-Delta position paper cited a number of arguments against the split structure including:

• The split structure is often impractical as it hinders recruiting top talent into a CEO position without the accustomed Chairperson position as well
• A split structure creates unclear roles and responsibilities for the CEO and the Chairperson
• The separation of the two roles creates a chairperson position that is very hard to fill
• The split structure provides no guarantee of good governance or company performance
• Separation of the two roles increases administrative complexity
• An independent chairperson may encourage an “overly ambitious” board.

Dr. Nygren offered two additional points with regard to the separation of the roles of CEO and Chairman. First, he pointed out that there appears to be no evidence to support the notion that splitting the roles improves (share price) performance in any measurable way. Secondly, the independent chairperson job is a significant and complex role to fill requiring a substantial commitment of time by a well experienced and talented person. This suggests significant financial compensation, which may well be seen as reducing the chairperson’s independence from the company management.

The Mercer-Delta position paper identified three situations where the split might make some sense in their view:

• Two senior leaders have worked very closely for a long time and decide to formally split their responsibilities, allowing each to focus on the jobs they find most rewarding or satisfying
• A crisis situation emerges requiring unquestioned and undistracted leadership at the board level.
• CEO succession may present an ideal time for such a split, especially if the outgoing CEO is leaving in disfavor.

Mercer-Delta proposed that the most beneficial approach to the separation of roles decision comes from not merely addressing this split, but from also instituting systemic and enduring governance practices including:

• Creation of a Lead or Presiding Director position
• Aligning board composition with corporate strategy
• Using comprehensive board and CEO/Chair evaluations
• Ensuring active involvement of the board in CEO succession and strategy formulation
• Ensuring strong board – senior management communication

In summary, Dr. Nygren noted, “Separating the role of the Chairman and the CEO may be too facile a solution to a more complex set of issues.” He said also that boards must do the hard work considering the costs and the benefits of each of the two choices. Finally, Dr. Nygren reflected Mercer-Delta’s view that “…in many instances
(separation) makes the best sense. In other circumstances, however, it will intensify failure because so few people are truly trained to understand the fundamental role and requirements of governing.” The question must be answered considering three key factors:

• The culture of the corporation and the board
• The context of the corporation, its industry and its circumstance
• The competence of the executive management and directors.

THE PANEL DISCUSSION

The panel discussion on the separation topic consisted of Mr. Doug Sims, CEO of CoBank; William Allen, Director of the Center for Law and Business at New York University; and Linda Scott, Director of Corporate Governance at TIAA-CREF. The panel was moderated by Ben Gerson, Senior Editor of Harvard Business Review.

Doug Sims, while cautioning that he was not on the panel as the “champion of separation” came out fully in favor of distinguishing between the roles of CEO and Chairperson. Mr. Sims has been CEO of CoBank for many years and has always worked with an independently elected Chairman. In fact, Mr. Sims does not even occupy a seat on the CoBank board of directors. He also noted that in the board room he, as CEO, has sufficient knowledge and influence that an actual seat on the board was not really necessary. He mentioned also that the only real reservation he has about the separation of his role as CEO and his Chairman’s role is the possibility that a Chairperson may want to usurp some of the prerogatives of the CEO office.

He noted that successful board operations under the separate structure is greatly facilitated by three factors:

• Clearly defined roles of the various positions, especially the CEO and the Chairman
• A comprehensive board operating manual, clearly spelling out how the board will operate
• A transparent management team that is very eager to fully educate the board regarding company operations. In fact, Mr. Sims suggested that the acronym CEO really stands for “Chief Education Officer” when it comes to board relations.

Mr. Sims also noted that the separation of the CEO and Chairperson roles is viewed very favorably by rating agencies and can therefore have quite positive impact on the company’s cost of capital.

Linda Scott noted that the question of separation of the two roles follows two very substantial questions the board must answer:

First, what are the fundamental purposes of the board of directors? And, secondly how should the board best accomplish these purposes? Ms. Scott suggested that the board of directors has four basic responsibilities: fiduciary oversight, continuity of leadership, review of strategic plans and equity policy regarding compensation. The question facing the board is how best to execute these responsibilities. Ms Scott suggested that the answer to this question involved three issues:

• The board must not only appear independent but must in fact be independent as well as act independently
• The board must have the right people as directors
• The board must have the right structure and policies.
With these practices, people and structure in place the board can deal effectively with the CEO / Chairperson separation issue. Ms. Scott suggested that the appropriate policy in this situation, in the absence of special circumstances, is to leave the separation of roles decision to the discretion of the board. If, however, the board decides to not separate the roles, it should appoint a Lead Independent Director or a Presiding Director. Finally, Ms. Scott noted that in the case of Mutual Fund Boards, the chairman should always be independent of the management company that runs the fund.

Mr. Allen took a position of being “very skeptical of separation.” He noted that, “We want our businesses to be institutions that produce long term social wealth and we want structures that facilitate that end.” Consequently any decision such as the separation of roles must be put to a rigorous cost / benefit / risk test and anything that can be done to reduce the agency cost of the corporate structure is a good thing. Mr. Allen suggested that the board is in the best position to take this determination and that the decision must reflect the particular circumstances and situation the firm faces at that particular time.

Clearly, Mr. Allen said, the CEO is the most knowledgeable person in the company and ought, therefore, to be the Chairman of the board as well. He fully agreed with Dr. Nygren that the separation decision might be “too facile” and give a false sense of confidence that the governance issue has been solved.

Mr. Allen said that he was very much in favor of the Lead Independent Director or Presiding Director position for two reasons. First, the board demands a source of leadership in times of crisis. Secondly, this position promotes the “tone of independence” on the board.

The position and the panel discussion spurred a very active discussion among the participants in the audience. Jim Cullen, Presiding Director for Johnson and Johnson suggested that the combined CEO and Chairperson position is very valuable in three corporate situations: crisis conditions, turnaround conditions and entrepreneurial situations. He noted that in these environments, debate over separation of roles or the existence of more than one source of authority might divert attention away from the central issues facing the company.

Doug Sims noted that the more important issue is whether or not the board assesses and takes a decision on the separation issue, rather than which way that decision goes.

Another participant posed a question to the panel and the audience: “What are the most important roles of the Non-executive Chairperson or the Lead Independent Director?”

Doug Sims responded with three points: setting the culture in the board room; helping to get the right skills on the board; and driving succession planning

Bill Allen offered two points: galvanizing reaction to early signs of long term poor performance; and managing the board’s own governance issues.

Linda Scott focused on succession planning, and Jim Cullen suggested maintaining communication with the CEO and other directors between meetings.

Jim Cullen noted that a key responsibility of the Presiding Director is to set the tone and agenda for the executive sessions of the board.

The discussion profiled two other notable problems with the separation decision. First, all agreed that the problems become very significant when the Non-Executive Chairperson is the former CEO who can subvert the leadership of the new CEO. Secondly, a poorly defined or poorly equipped Lead Independent Director can substantially muddy the water and confuse issues of control and leadership regardless of how much procedure is installed.
CCE POSITION

The Center for Corporate Excellence (CCE) certainly agrees with the tone of the debate on this issue that it is a very complex and dynamic problem. No single answer is appropriate for all companies in all circumstances. CCE also recognizes that this question is merely one of many important issues facing boards and will not by itself cure all the firm’s governance problems.

The Center also recognizes the key arguments against the separation of the CEO and Chairperson roles.

- Recruitment of top level CEO talent is hindered by the separation when the opposite is the norm in the industry
- The position of independent, non-executive Chairperson is a very big job demanding significant compensation, which may detract from the perceived independence of the Chairperson.
- Having a non-executive chairperson and a CEO can cause confusion of leadership, roles and responsibilities both in the boardroom as well as in the executive suite.
- Certain circumstances such as financial crisis, business turnaround or entrepreneurship are sufficiently urgent that a single source of authority and responsibility is necessary.

The Center for Corporate Excellence (CCE) is not persuaded by the arguments that the separation of roles causes administrative difficulty for management. The Center is also not impressed with the assertion that there is no apparent relationship between the separation of the CEO and Chairperson roles and the price performance of the company’s shares. CCE does not believe it is the board’s job to make the administrative tasks of management easier, especially if it is at the cost of independent governance; nor that it is the board’s job to take governance decisions solely because it may influence the company’s share price. While the price of a company’s stock is a very valuable and important measure of certain corporate decisions, it is not necessarily a good measure of a corporation’s governance. The job of a corporation’s board is to govern, not to manage the corporation’s administration or investor relations.

CCE also recognizes several key arguments in favor of the separation of the CEO and Chairperson roles including:

- The need for representation of shareholders that is independent of corporate management
- The requirement for a source of oversight of management that is independent of management
- The need for the board to manage its own governance issues independently of the influence of management
- The advantages of having an independent partner for the CEO especially in times crisis or difficulty
- The opportunity to take advantage of two very practical immediate situations:
  - Favorable reaction by rating agencies
  - Increasing demands by various stakeholders in the corporation

The perspective preferred by the Center for Corporate Excellence is that the positions of CEO and Chairperson should in most cases be separate and that this should be the default position of the board of directors. However, CCE recognizes that in certain circumstances as noted above in this paper, it is appropriate to combine the two positions in a single executive. As was recommended by the U. K. Cadbury Code, companies taking the position of combining the positions must inform the investor community why they have taken that position. If a company decides to combine the roles of CEO and Chairperson the board must accept three requirements:
• Elect a Lead Independent Director or a Presiding Director.

• Define the roles and responsibilities of this Lead Independent Director or Presiding Director very clearly and distinguish those roles and responsibilities from those of the CEO / Chairperson.

• Most importantly, the board must clearly define precisely how it will execute independent oversight of management with the CEO also being the Chairperson of the board of directors. The authority and responsibility of the Lead Independent Director or Presiding Director must be supreme and unfettered in this regard.

SUMMARY
The Center for Corporate Excellence supports separating the roles of the CEO and chairperson. Separating the roles allows the board to function independently of management in the following ways; show independent representation to shareholders, be a source of management oversight and manage governance issues. The Center also recognizes that it is one thing to recommend a particular course of action, but an entirely different thing to suggest how to actually implement that recommendation. The guiding principle in this issue should be:

The CEO manages the company.

The Chairman manages the board.