CEO and Chairman of the Board: The Controversy in Corporate Governance

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ABSTRACT

About half of the companies that make up the S&P 500 Index have one individual as the CEO & Chairman rather than splitting each role amongst two individuals. In a combined role of CEO and Chairman of the Board, a company has no issue determining who is in charge of the goals and outcomes of the organization. This leadership structure has potential for setting clear company objectives and maintaining efficiency coming from one voice; however, it leaves many loopholes to be taken advantage of if the individual were to act in his or her own best interest. This project serves to provide further research and explanation into what would be the overall best resolution for U.S. companies, comparing the pros and cons of the two leadership structures and ultimately concluding that a combined CEO/Chairman of the Board structure should not remain an acceptable practice in the U.S. The ethical risks outweigh any potential success of combined leadership, often resulting in scandal, fraud, and failure. For each decision to be in the best interest of the shareholders, the decision power should be split into two different hands—one CEO and one Chairperson.

"Combining titles results in the CEO grading his own homework…" [1]

BACKGROUND

What is corporate governance?

- In this research, corporate governance concerns "the resolution of collective action problems among dispersed investors and the reconciliation of conflicts of interest between various corporate claimholders" and provides a structure for "outside investors [to] protect themselves against expropriation by the insiders."[2]

What are the objectives of the Board of Directors?

- The Board of Directors holds the utmost responsibility for the governance of a company. Duties of the Board include ensuring that all activities are in accordance with both regulations and the company's mission while acting in the best interest of the organization, selecting and evaluating the CEO, and participate ethically in committees such as the audit, compensation, and nominating committee.

What is the role of Chairman of the Board?

- The most prominent obligation of the Chairman of the Board is to liaise between the Board and company management without directly participating in company operations.[3] He/she obtains the authority to call board meetings and executive sessions, and the Chairman both leads and sets the agenda for these sessions.

What is a Lead Independent Director?

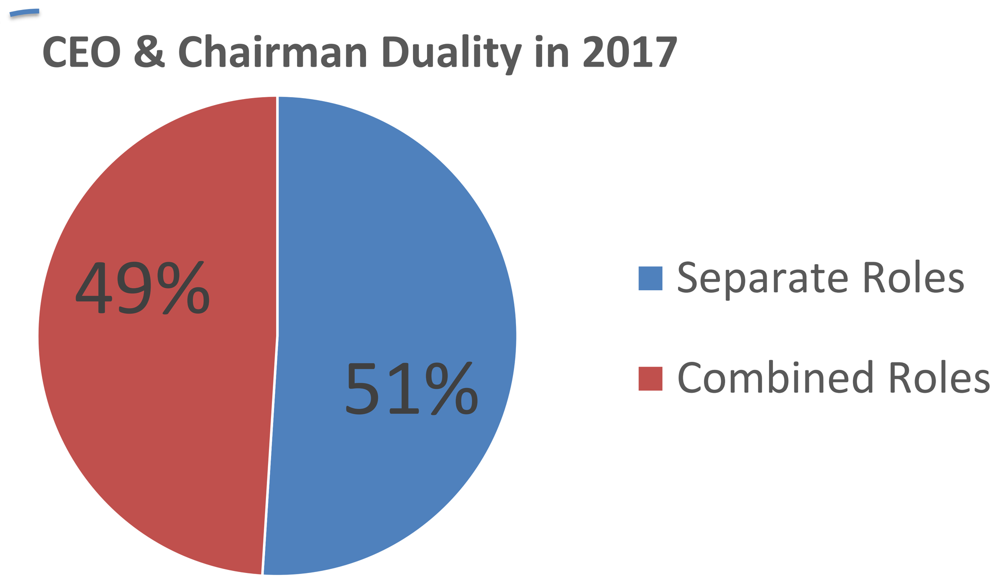
- For decades, companies only had two options: two individuals in separate roles of Chairman and CEO or a combined role of Chairman and CEO with one leader carrying out both duties. A third option was proposed by Lipton and Lorsch in 1992: "retaining the CEO as board chair and the appointment of a lead independent director."[3] The Lead Independent Director is responsible for keeping the board focused, coordinating committees, maintaining a positive relationship between the CEO/Chairman and the Board, and supporting effective shareholder communication as the shareholders' contact.[3]

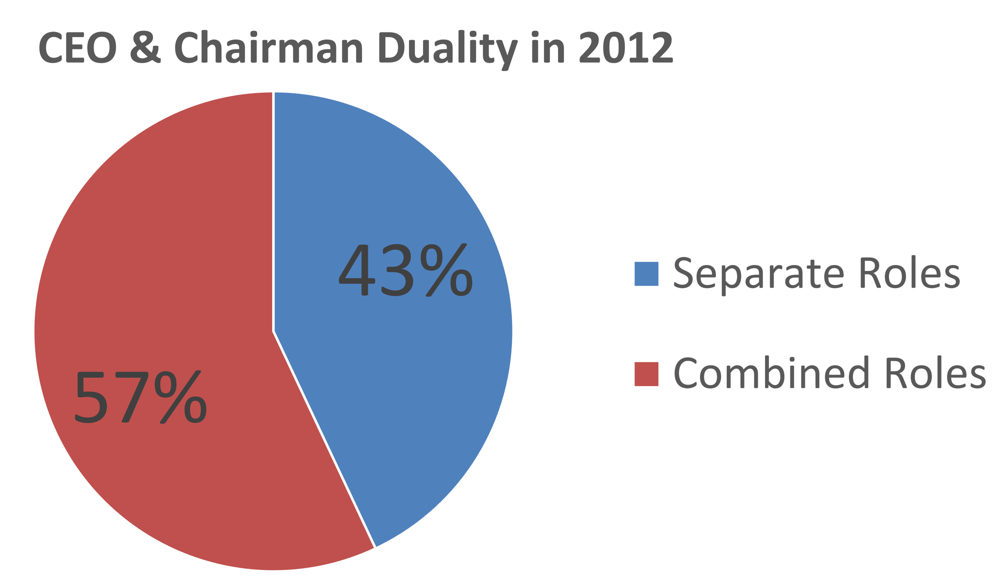
METHODOLOGY

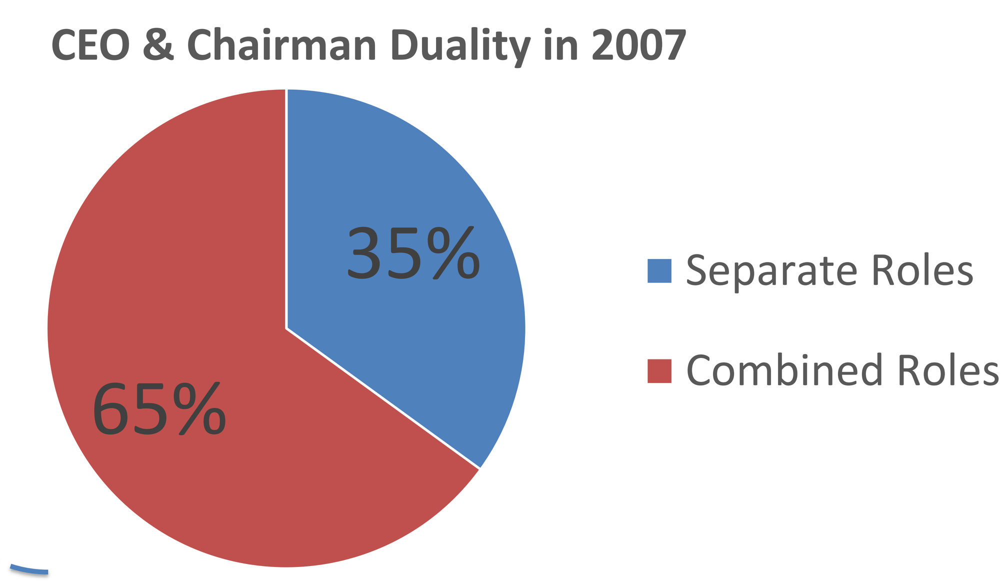
This project took the form of a literature review, a discussion of published scholarly journals and research, with personal interpretations of the corporate governance environment and where it is headed. By analyzing academic journals on CEO/Chairman duality, one can see how corporate structure has evolved over time, what initiated and resulted from those changes, and ultimately that additional policies consistent across all United States publicly traded companies may need to be enforced. Detailed data and statistics were available to me through the Spencer Stuart U.S. Board Index, an extensive index published each year with the latest trends and data in board governance practices, board composition, and director compensation in S&P 500 companies. By using this index, reading through a surplus of academic research and journals, and analyzing historic fraudulent cases and policies that resulted from those cases, I was able to reach my conclusions and recommendations.

CEO & CHAIRMAN DUALITY OVER TIME

The following charts depict the percentage of S&P 500 companies with a separate vs. a combined CEO/Chairman of the Board in the past decade.[4]







OVERARCHING PROS AND CONS

PROS of Combined Leadership	CONS of Combined Leadership
❖ *Clear-cut leadership in instilling organizational effectiveness*	❖ *CEO already has so many duties → Board matters get the short end of the stick*
❖ *More decisiveness → no need to make compromises between two minds*	❖ *Board leadership becomes hierarchy with less balance of power*
❖ *Can provide the Board with greater insight into day-to-day operations*	❖ *CEO may choose to act in his/her best interest rather than stakeholders' interests*
❖ *One public spokesperson*	❖ *Less cost effective*

CONCLUSIONS

With research supporting that separating the roles of CEO and Chairman of the Board is more cost effective and research repeatedly proving to be inconclusive on the topic of whether one structure more positively affects performance than another, why risk the potential unethical behavior that could derive from a combined CEO/Chairman? It will ultimately continue to come down to the agency theory: separating the two roles will increase Board independence from management and therefore lead to improved oversight.

Companies should not necessarily be required to have a Chairman of the Board that is completely independent (i.e. could have some involvement/relationship with the company) but should definitely be required to have two separate individuals holding the roles of Chairman of the Board and CEO. At the absolute least, companies with a dual CEO/Chairman should be required to appoint a Lead Independent Director.

SELECTED REFERENCES

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