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BOARD LEADERSHIP AND CEO-CHAIRMAN SPLIT: A LITERATURE REVIEW

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Board Leadership and CEO-Chairman Split: A Literature Review

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Abstract – With the advent of various changes in Corporate Law and in the field of Corporate Governance, several issues have come up that need greater in depth study in order to find a solution. One of them is the Great Divide between the positions of Chief Executive Officer, on one hand and Chairman, on the other. Historically, Chairman was the senior most member of the board. However, later with the introduction of the "Separate Ownership and Management" feature in a Company form of business organization, the term CEO was introduced. The board of directors also became a monitoring body instead of advisory body. In the 1990's an urgent demand for independent directors on board was raised which culminated into a debate of CEO-Chairman split. There are some in the favour of splitting the positions as it would lead a separate independent Chairman monitoring a CEO leading to transparency and better decision making. While there are some against the splitting as it gives a passive signal to the rest of the board that all activities will be conducted by two. This paper tries to examine the relationship between the two roles, the advantages and disadvantages associated with splitting the positions, going through the Literature along with the current legal developments in this area in India and some other countries and finally tries to provide a conclusion.

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INTRODUCTION

The choice of dual leadership structures received increased attention from regulators, institutional investors and the business press in the last decade, in part due to recent corporate scandals and related concerns of the strength of firms' governance structures. Putting simply, the CEO is the primary manager of a company and the chairman is the head of the board, which oversees management. There's really no good reason why one person should do both jobs. And there's really no sense in recombining the two roles when a company's problems are resolved. The common wisdom is that separating the roles serves up a better governance structure for shareholders because it provides a better balance of power. In response to such calls for separation, CEOs and many corporate directors often argue that separating the CEO and board chairperson roles risks losing unity of command. But at the same time, many members of the corporate governance community argue that a CEO who also chairs the board enjoys unchecked power that could potentially be used toward nefarious ends. CEOs have unparalleled superior knowledge regarding the industry and the firm's internal conditions. Combining the CEO and chairperson positions doesn't necessarily indicate complete transfer of critical information between CEO and board members. That is, dual CEO as board chairperson can more easily tailor content and information to the boardroom. As a result, dual CEOs can capitalize on information asymmetry exerting influence on board decision –making processes. This structural context might further reduce the board's ability to effectively monitor and control the managerial initiatives that do not serve corporate shareholders. Thus combining the position of CEO and board chairperson weakens board's effectiveness in controlling and monitoring function, thereby increasing agency costs. Without the strength obtained from the separation of CEO and chairperson position, board effectiveness in controlling managerial opportunism in corporate strategic management is further diminished. Building on these theoretical arguments, we expect that the hierarchical and information power given to dual CEO will enhance the CEO's ability to pursue self-serving opportunities in strategic management of the firm. Thus we predict that CEO duality leadership to be an antecedent of increased level of corporate unrelated diversification.

A management structure in which two executives hold these positions facilitates checks and balances and mitigates owner–manager agency problems. It

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also allows the two executives to share the management tasks and better utilize their relative strengths.

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LITERATURE REVIEW

Commenting on splitting leadership roles, management theorist Henri Fayol wrote, “A body with two heads is in the social as in the animal sphere a monster, and has difficulty in surviving.” One part of the literature argues that a leadership structure in which two executives fill these positions is preferred because it facilitates better monitoring of top management activities and thus reduces owner-management agency costs (see, for example, Rechner and Dalton, 1991; Pi and Timme, 1993). A separate set of studies, and the majority of CEOs, argue that combining the two titles enhances firm value. A management structure in which one executive fills these positions facilitates a stronger and clearer leadership and/or better communication between management and the board of directors (see, for example, Donaldson and Davis, 1991; Dahya et al., 1996; Brickley et al., 1997; Bhagat and Black, 1998). Several other studies do not find a significant impact of leadership structure on firm value (see, for example, Berg and Smith, 1978; Chaganti et al., 1985; Daily and Dalton, 1993, 1997; Baliga et al., 1996; Fosberg, 1999). Dahya and Travlos (2000) provide a comprehensive review of this literature. A management structure in which one person holds both positions provides a clearer set of directions for the company and facilitates better communication between the board of directors and management. CEO duality increases the information duality between the CEO and the board, which may become the primary source of agency problems (Eisenhardt, 1989). The recent scrutiny and controversy over dual leadership structures triggered an increase in the number of firms opting to separate the CEO and chairman roles (Grinstein and Valles Concept)

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CONCEPTUAL AND POLICY FRAMEWORK

Shareholders elect a board of directors, who in turn hire a Chief Executive Officer (CEO) to lead management. The primary responsibility of the board relates to the selection and retention of the CEO. However, in many U.S. corporations the CEO and Chairman of the Board roles are held by the same person. This creates an inherent conflict of interest between management and the board.

Capital market watchdog SEBI wants listed companies to voluntarily consider separating the posts of chairman and managing director as a good governance practice because making it mandatory may not be feasible yet.

The Securities and Exchange Board of India (Sebi) has expressed its views in the new corporate governance code, which listed companies need to implement by October 1. The code was cleared by the regulator's board and is being finalised for necessary notification

There have been suggestions that companies should have different persons for the roles of chairman and managing director (or chief executive officer) to avoid one person getting unfettered powers of management.

The requirement to segregate the roles is common in developed countries such as the US, the UK and France.

Sebi had sought feedback in its consultation paper on new corporate governance norms on the need to separate the positions of chairman and MD.

The new Companies Act provides for such a separation unless the articles of a company provide otherwise or a company does not have multiple businesses.

While a majority of the comments received in response to the consultative paper favoured mandatory separation of the posts, Sebi's Primary Market Advisory Committee (PMAC) recommended that separate posts not be mandated.

Agreeing with the PMAC recommendation, the regulator proposed that separate posts for the chairman and MD/CEO may not be mandated considering the extant provisions that mandate a higher number of independent directors if there is an executive chairman.

"However, it is proposed that the separation of the post of Chairman and MD/CEO may be implemented by companies as a good governance practice," Sebi concluded.

On a PMAC recommendation to have a majority of independent directors in the absence of a regular non-executive chairman, Sebi said this proposal appeared to be "too onerous."

"It is proposed to address the concern of PMAC by incorporating the provision that boards of companies which do not have a regular non-executive chairman shall have at least half of the board as independent," the regulator said.

In most public sector enterprises, as also many large private sector companies, the posts of chairman and managing director are held by the same person.

The PMAC had observed that the question of mandatory separation of chairman and CEO posts was not settled globally yet and a good number of companies already had different individuals for these positions. Separation of Offices of Chairman & Chief Executive Officer Proviso to clause 203 (1) “Provided that an individual shall not be appointed or reappointed as the chairperson of the company, in pursuance of the articles of the company, as well as the managing director or Chief Executive Officer of the company at the same time after the date of commencement of this Act unless,— (a) the articles of such a company provide otherwise; or (b) the company does not carry multiple businesses” No explicit provision. However, relaxed requirement of only one-third Independent Directors in case of Non-Executive Chairman.

CONCLUSION

Board leadership structure has come under fire since the corporate financial scandals, and recent regulations have mandated disclosures justifying a combination of the roles of the CEO and the board chairman. A fair number of firms have opted to split the roles due to pressure from activist investors. Critics of a combined leadership structure are concerned that this may reduce monitoring effectiveness by the board and create a setting that provides the CEO with more opportunities to make self-serving decisions. These views seem quite predominant despite the lack of definite conclusions in the literature regarding the implications of CEO duality. Effect of splitting the CEO and board chair positions on future performance would be contingent on how the company was performing prior to the separation. In other words, rather than being a universal prescription for positive results, we positioned that the effect of the separation would depend on how the company was doing at the time it split its CEO and board chair roles. Rationale behind this is that for the separation, to have an effect, there must be a reaction to something. We theorised that, for a separation to have a positive effect on future performance, it must be a reaction to poor company performance. Conversely, we predicted reacting to good performance with a separation event would have the opposite effect and hurt performance in the future. While CEO-board chair separation can be beneficial if conducted properly and under the right circumstances, it can be detrimental to performance, akin to taking medicine when you are not sick, if undertaken without considering performance. In our view, boards should view their choice of leadership structure as a strategic concern to be assessed in the context of the company’s internal strengths/weaknesses and external opportunities/threats. In other words, the form of governance selected by the board is a reflection of how the company can best deploy its governance resources to gain and sustain a competitive advantage. It can happen gradually, in succession. The important point is to remember there is more than one way to protect shareholders’ interests. Careful evaluation of the board’s dynamics alongside those of the management team, the company’s position in the marketplace, and indeed the condition of the market itself, will lead to the best decision.

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