CHAIRMAN AND CEO

THE CONTROVERSY OVER BOARD LEADERSHIP STRUCTURE

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INTRODUCTION

One of the most controversial issues in corporate governance is whether the CEO of a corporation should simultaneously serve as chairman of the board. According to Spencer Stuart, just over half (52 percent) of companies in the S&P 500 Index are led by a dual chairman/CEO, while 29 percent have an independent chair and 19 percent an executive or other outside chair.[1] In recent years, the trend has consistently moved toward separation; 10 years ago, 71 percent of S&P 500 companies were led by a dual chairman/CEO and 15 years ago 77 percent were (see Exhibit 1).[2]

In theory, an independent chairman improves the ability of the board of directors to oversee management. By separating the positions, a company clearly differentiates between the roles of the board and management, and gives one director clear authority to speak on behalf of the board and to run board meetings. Separation eliminates conflicts in the areas of performance evaluation, executive compensation, succession planning, and the recruitment of new directors. It also allows the CEO to focus exclusively on strategy, operations, and organizational issues while the chairman focuses on management oversight, board leadership, and governance-related matters.

However, separation of the chairman and CEO roles is not unambiguously positive. Mandating separation can be artificial, especially when the company already has an effective dual chairman/CEO in place. Separation can lead to duplication of leadership, impair decision making, and create internal confusion, particularly in times of crisis. It can also make the recruitment of a new CEO difficult if qualified candidates expect to hold both titles. This is especially true when the new CEO is an external hire.

There is little research support for requiring a separation of these roles. Most research finds that the independence status of the chairman is not a material indicator of firm performance or governance quality. Dalton, Daily, Ellstrand, and Johnson (1998) provide a meta-analysis of 31 studies and find no relationship between board leadership structure and firm performance.[3] Krause, Semandeni, and Cannella (2013) review 48 studies and find that the chairman status has little impact on performance, managerial entrenchment, organizational risk taking, or executive compensation.[4] Balinga, Moyer, and Rau (1996) examine situations where companies change leadership status (through either a combination or separation of the roles) and find no evidence that this decision impacts subsequent performance.[5] Dey, Engel, and Liu (2011) find that forced separation due to shareholder pressure is associated with a decrease in market valuation and lower future operating performance, suggesting that mandatory separation can actually be harmful.[6]

Despite this research evidence, shareholder activists and many governance experts remain active in pressuring companies to divide their leadership structure. For example, a representative of CalPERS argued at the ExxonMobil annual meeting that having a dual chairman/CEO is "like grading your own exam papers."[7] According to an activist at a Bank of America meeting, "The roles of CEO and chair of the board have inherent conflicts, which require the two posts to be separate and independent."[8] Proxy advisory firm Institutional Shareholder Services recommended stripping JPMorgan Chase CEO Jamie Dimon of his chairman title, saying that "shareholders would benefit from the strongest form of independent board oversight which an independent chairman could provide."[9] To this end, shareholder activists have steadily lobbied companies through the proxy-voting process to have a fully independent chairman, although their efforts have been met with little success (see Exhibit 2).[10]

CHAIRMAN AND CEO STRUCTURE

Given the controversy over chairman/CEO duality, we examined in detail the leadership structures of publicly traded corporations and the circumstances under which they are changed. Our sample includes the 100 largest and 100 smallest companies in the Fortune 1000 in 2016.[11] The measurement period includes the 20-year period 1996-2015. After eliminating mutual companies, our final sample includes 187 firms and 3,525 firm-year observations.

Consistent with the Spencer Stuart data above, companies are much more likely to have a dual chairman/CEO than an independent or separate chairman. Taking into account all 3,525 firm-year observations, 61 percent of the time companies had a dual chairman/CEO, while 39 percent of the time they separated the roles. Large companies (69 percent) are more likely than small companies (53 percent) to have combined leadership, although even among small companies duality is the prevailing standard.

We find that board leadership structures are not stable. Only a third (34 percent) of companies made no changes during the entire 20-year measurement period. Slightly under half of these consistently maintained separate chairman and CEO positions (such as Costco, Intel, and Walgreens); slightly more than half of these consistently combined them (such as Amazon, Berkshire Hathaway, and ExxonMobil). Still, these companies are the exception rather than the rule. It is significantly more likely that a company makes at least one change to board leadership structure (combination or separation) over time. On average, companies made 1.7 changes, or approximately 1 change every 12 years. Changes are more frequent among large companies (2.2 changes, on average) than smaller companies (1.3 changes). In both cases, companies are slightly more likely to separate the roles than to combine them (see Exhibit 3). This is also consistent with the trends observed in the Spencer Stuart data cited earlier.

Most separations occur during the succession process, with the former CEO, founder, or other officer continuing to serve as chair on either a temporary or permanent basis. Of the 171 separations in our sample, 134 (78 percent) are associated with an orderly succession. This is true of both small and large companies. However, large companies are significantly more likely to separate the roles temporarily, whereas smaller companies are more likely to do so permanently (see Exhibit 4). Researchers have long noted that temporary separation can lend stability to the CEO succession process, allowing the new CEO time to gain experience in one role before adding the responsibilities of chairmanship.[12] For example, when Sam Palmisano was promoted to CEO of IBM in 2002, outgoing CEO Lou Gerstner remained chairman for a 12-month period before stepping down from that position as well and passing the chairman title to Palmisano. In 2012, IBM replicated the process, promoting Virginia Rometty to CEO, with Palmisano remaining as chair for 10 months before promoting Rometty to dual chairman/CEO. Other companies—such as Alphabet, Ford Motor, and Microsoft—separated the roles permanently following a CEO succession, with the outgoing CEO remaining chairman.

Approximately a quarter (22 percent) of separations are not part of an orderly succession. Nine percent follow an abrupt resignation of the CEO, 6 percent a governance issue (such as accounting restatement or CEO scandal), 3 percent a merger, 2 percent a shareholder vote, and 2 percent are required of the company as part of a government bailout. Hewlett-Packard split the roles for 2 years following the sudden termination of Carly Fiorina in 2005 and split them again for 4 years following the termination of Mark Hurd in 2010. Boeing split the roles following a procurement scandal in 2003, AIG following an accounting scandal in 2005, and UnitedHealth following a stock-option backdating scandal in 2006. Home-mortgage insurer Freddie Mac was forced to separate the chairman and CEO roles following conservatorship in 2008. (Ironically, its sister company Fannie Mae, which joined Freddie Mac in conservatorship, had already separated the roles following an accounting scandal in 2004.) In only one case in our sample did the CEO resign abruptly but remain chairman. This occurred in 2010 when the CEO of Newfield Exploration retired early as CEO of the company to assume the role of interim chairman and CEO of Baker Hughes following an accounting scandal at that company; still, he remained non-executive chairman of Newfield Exploration.

The decision to combine the chairman and CEO roles tends to be more uniform. The vast majority of combinations (91 percent) involve an orderly succession at the top. Only 9 percent are associated with a merger, sudden resignation, or governance-related issue. In 90 percent of combinations, the current CEO is given the additional title of chair; in 10 percent of cases, a new CEO is recruited to become dual chair/CEO (see Exhibit 5).

Most interesting, perhaps, is the frequency with which companies "permanently" separate the leadership roles only to recombine them at a later date. Slightly over one-third (34 percent) of companies in our sample permanently separated the chairman and CEO roles and later recombined them during the 20-year measurement period (see Exhibit 6).[13] Best Buy split the roles for nearly 13 years when founder and chairman Richard Schultze stepped down as CEO in 2002; Schultze eventually resigned from the board and when his successor as chairman retired in 2015, then-CEO Hubert Joly was given the additional title of board chair. The company gave no public explanation of its decision to recombine the roles. General Motors "permanently" separated the roles following its government bailout in 2009 and recombined them 8 months later when then-chairman Robert Whitacre became CEO on an interim and then permanent basis. (Whitacre explained the move by saying, "The board looked at the potential candidates and decided that this place needs stability. We don't need any more uncertainty.")[14] Bank of America and Walt Disney both separated the chairman and CEO roles following shareholder votes, and subsequently recombined them five and nine years later, respectively, under different management. In both cases, the board justified the decision to recombine as rewarding the successful leadership of the current CEO.

In the cases of Bank of America and Walt Disney, the decisions to recombine the roles were highly controversial. (According to one Bank of America investor, "They [the board] have flaunted the will of shareholders. … It's like the board poking their finger in the eye of the investors.")[15] Across the entire sample, however, shareholder response was unexpectedly varied. Best Buy, Comcast, and Merck (which separated the roles following the significant litigation over its pain-relieving drug Vioxx) faced almost no pushback from shareholders when they subsequently recombined the roles. Others such as Boeing, Anthem (Wellpoint), and McKesson faced considerable shareholder criticism. Only 34 percent of the companies that separated and recombined the chairman and CEO roles were targeted by shareholder-sponsored proxy proposals to require separation. Average support for these proposals was 33 percent, not significantly different from companies that consistently maintain a dual chairman/CEO structure (34 percent support) or that separate the roles temporarily during succession (36 percent support). It was also not significantly different from the average support across the total universe of companies that face shareholder-sponsored proposals requiring separation (32 percent).[16]

Finally, it is interesting to note that pressure to separate the chairman and CEO roles seems to center almost exclusively on large companies. Only 3 of the 95 small companies in our sample were the target of a shareholder proposal to require an independent chairman over the entire 20-year measurement period, even though their board leadership structures are not significantly different from those of larger corporations. By contrast, a majority (56 out of 92) of large companies were targeted at least once. This suggests that the companies that shareholders target to advocate for independent board leadership might not necessarily be those with the most egregious governance problems but instead those that are the most visible public targets.

WHY THIS MATTERS

1. Many governance experts and shareholder activists believe that the CEO of a corporation should never serve as chairman of their own board. The research literature, however, contains little evidence that chairman/CEO duality is on average detrimental to future performance or governance quality. Why do activists advocate that corporations—especially large corporations—strictly separate the chairman and CEO roles? How much of this activism is publicity-seeking rather than an attempt to improve corporate governance?
2. Research evidence suggests that the benefits and drawbacks of independent board leadership are situation-dependent. It is not always clear, however, which situations benefit from shared leadership and which benefit from combined leadership. What factors should the board consider in deciding whether to combine or separate board leadership? Which structure should be the default setting for a company?
3. General Motors cited "stability" when justifying the decision to recombine the chair and CEO roles in 2010. Is a combined chairman/CEO structure more stable than separate leadership? How can the board weigh the tradeoffs between stability of leadership, efficient decision making, and decreased oversight? ■

[1] Spencer Stuart Board Index (2015).
[2] Spencer Stuart Board Index (2010).
[3] Dan R. Dalton, Catherine M. Daily, Alan E. Ellstrand, and Jonathan L. Johnson, "Meta-Analytic Reviews of Board Composition, Leadership Structure, and Firm Performance," *Strategic Management Journal*, (1998).
[4] Ryan Krause, Matthew Semandeni, and Albert A. Cannella, Jr., "CEO Duality: A Review and Research Agenda," *Journal of Management*, (2013).
[5] B. Ram Baliga, R. Charles Moyer, and Ramesh S. Rao, "CEO Duality and Firm Performance: What's the Fuss?" *Strategic Management Journal*, (1996).
[6] Aiyesha Dey, Ellen Engel, and Xiaohui Liu, "CEO And Board Chair Roles: To Split or Not to Split?" *Journal of Corporate Finance*, (2011).
[7] "ExxonMobil Annual Shareholder Meeting," *FD (Fair Disclosure) Wire*, (May 25, 2016).
[8] "Bank of America Corp Extraordinary Shareholders Meeting," *FD (Fair Disclosure) Wire* (September 22, 2015).
[9] Neha Dimri and Amrutha Gayathri, "Proxy Firms Recommend JPMorgan Shareholders Vote Against Pay Plan," *Reuters* (May 6, 2015).
[10] John Laide, "Issue Focus: Separate Chairman and CEO," SharkRepellent (September 18, 2015).
[11] We include both large and small companies to reduce distortions due to company size.
[12] See James A. Brickley, Jeffrey L. Coles, and Gregg A. Jarrell, "Leadership Structure: Separating the CEO and Chairman of the Board," *Journal of Corporate Finance*, (1997).
[13] These figures exclude the temporary (one-to-two year) separations during orderly transitions. They include all companies that were "permanently" separated at the beginning of the measurement period, merger-related separations, and all separations following disorderly terminations or corporate governance-related scandals.
[14] Tom Krishner and Dee-Ann Durbin, "Whitacre Takes over CEO Job on Permanent Basis after 7 Weeks as the Interim Boss," *Associated Press Newswires* (January 25, 2010).
[15] Christina Rexrode and Dan Fitzpatrick, "Investors Push Back at BofA's Reversal," *The Wall Street Journal* (October 31, 2014).
[16] SharkRepellent, *loc. cit*. See Exhibit 2.

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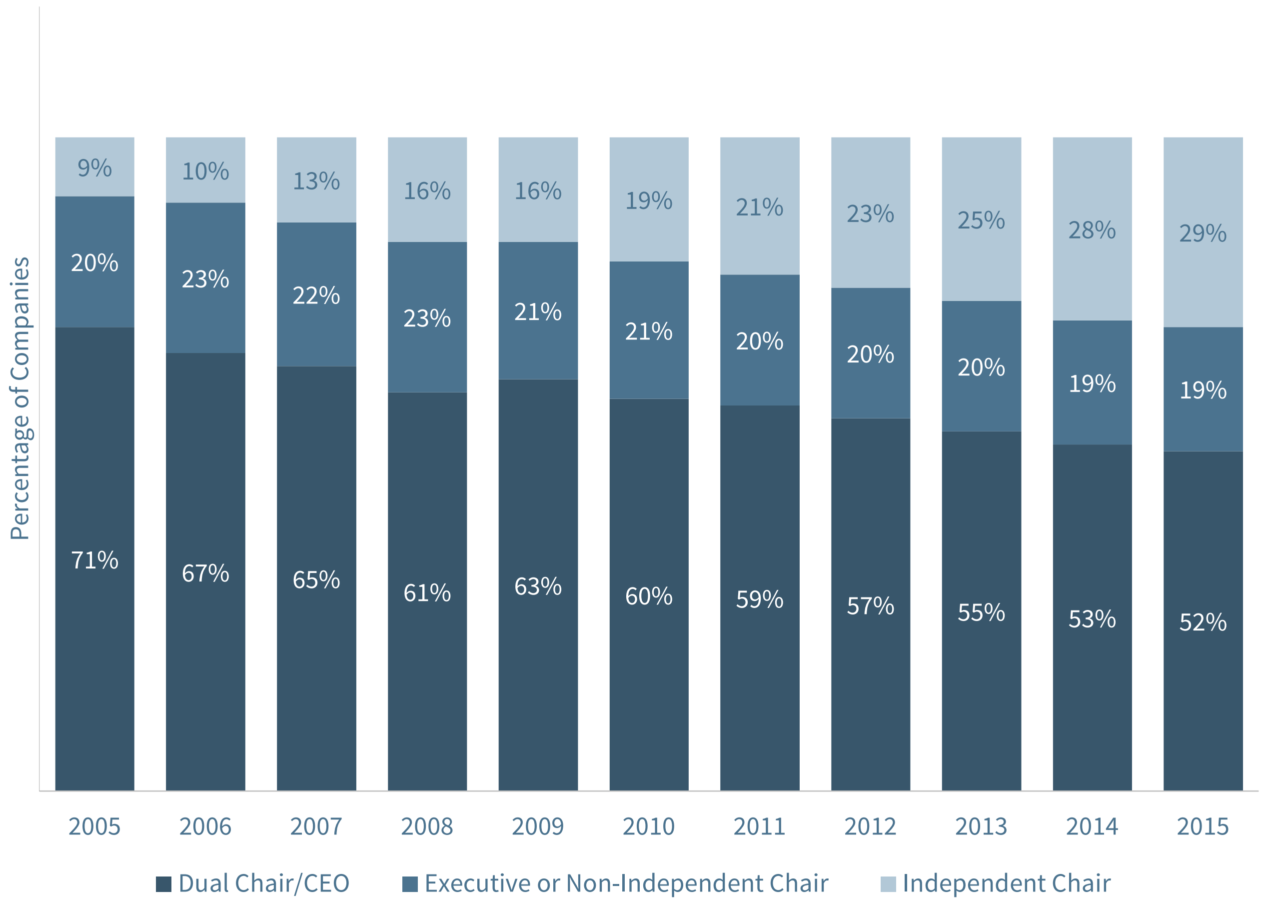
EXHIBIT 1 — INDEPENDENCE STATUS OF BOARD CHAIR



Note: Sample includes companies in the S&P 500 Index.

Source: Spencer Stuart Board Index.

EXHIBIT 2 — SHAREHOLDER-SPONSORED PROPOSALS REQUIRING INDEPENDENT CHAIRMAN

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total
Proposals voted	31	54	45	28	37	45	27	56	62	63	63	511
Pass	1	2	4	1	3	0	3	4	6	4	2	30
Fail	30	52	41	27	34	45	24	52	56	59	61	481
Failed but majority of yes/no	0	0	0	0	0	1	0	0	1	0	0	2
Avg support: Independent chair	28%	30%	27%	29%	32%	29%	33%	35%	32%	31%	29%	31%
Avg. support: Shareholder proposals	29%	32%	30%	30%	35%	34%	34%	35%	33%	31%	33%	32%

Note: "Average support: shareholder proposals" includes the average support for all shareholder-sponsored proxy proposals across all issues voted on during the year and is shown for comparison purposes.

Source: SharkRepellent. Sample includes all 14a-8 proposals tracked by FactSet.

EXHIBIT 3 — BOARD LEADERSHIP STRUCTURE

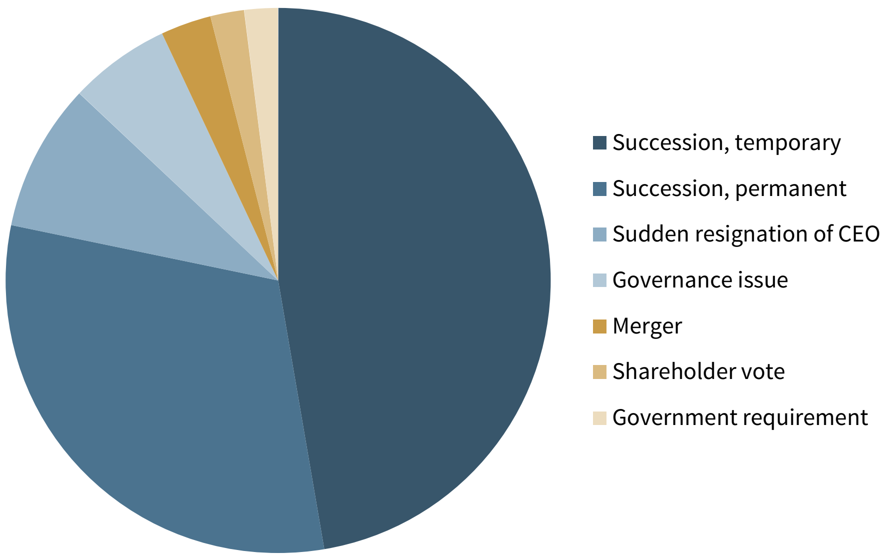
	All Companies	Large Companies	Small Companies
Sample	187	92	95
Firm-year observations	3,525	1,894	1,631
Combined chairman/CEO			
% of firm-year observations	61%	69%	53%
# firms always combined	36	16	20
% firms always combined	19%	17%	21%
Separated chairman/CEO			
% of firm-year observations	39%	31%	47%
# firms always separated	27	7	20
% firms always separated	14%	8%	21%
Changes to leadership structure, total			
# of changes	325	205	120
# of separations	171	106	65
# of combinations	154	99	55
Changes to leadership structure, avg. per company			
# of changes	1.7	2.2	1.3
# of separations	0.9	1.1	0.7
# of combinations	0.8	1.1	0.6

Note: Sample includes 187 firms (3,525 firm-year observations) between 1996 and 2015, derived from the largest 100 and smallest 100 companies in the Fortune 1000 as of 2016. Mutual companies are excluded. Total changes to leadership structure include all changes made during the entire sample of 3,525 firm-year observations.

Source: Securities and Exchange Commission and Factiva. Calculations by the authors

EXHIBIT 4 — SEPARATIONS AND COMBINATIONS

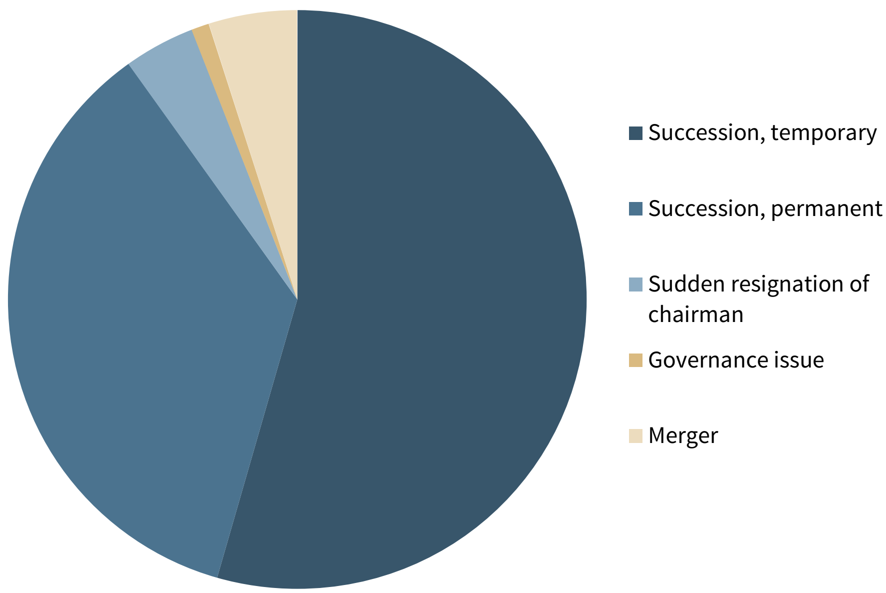
SEPARATION OF CHAIRMAN AND CEO



	All Companies	Large Companies	Small Companies
Succession, temporary	47%	55%	35%
Succession, permanent	31%	20%	49%
Sudden resignation of CEO	9%	8%	11%
Governance issue	6%	8%	5%
Merger	3%	5%	0%
Shareholder vote	2%	3%	0%
Government requirement	2%	3%	0%

EXHIBIT 4 — CONTINUED

COMBINATION OF CHAIRMAN AND CEO



	All Companies	Large Companies	Small Companies
Succession, temporary	55%	62%	42%
Succession, permanent	36%	30%	47%
Sudden resignation of chairman	4%	2%	7%
Governance issue	1%	0%	2%
Merger	5%	6%	2%

Source: Securities and Exchange Commission and Factiva. Calculations by the authors.

EXHIBIT 5 — IMPACT OF SEPARATION/COMBINATION ON CURRENT CEO

	All Companies	Large Companies	Small Companies
Separation of chairman/CEO			
Former CEO remains chair, #	128	78	50
Former CEO does not remain chair, #	43	28	15
Former CEO remains chair, %	75%	74%	77%
Former CEO does not remain chair, %	25%	26%	23%
Combination of chairman/CEO			
Current CEO adds chair title, #	138	91	47
Current CEO not selected as chair, #	16	8	8
Current CEO adds chair title, %	90%	92%	85%
Current CEO not selected as chair, %	10%	8%	15%

Source: Securities and Exchange Commission and Factiva. Calculations by the authors.

EXHIBIT 6 — COMPANIES THAT SEPARATE AND THEN RECOMBINE CHAIRMAN/CEO ROLES

	All Companies	Large Companies	Small Companies
Companies that separate and then recombine, #	64	34	30
Companies that separate and then recombine, %	34%	37%	32%
Shareholder-sponsored proposals requiring separation	22	21	1
% vote in support of shareholder proposals	33%	33%	33%

Source: Securities and Exchange Commission and Factiva. Calculations by the authors.