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Splitting The CEO And Chairman Roles—Yes Or No?

Let company needs rather than activist pressures guide your decision.

by Charles Tribbett

Russell Reynolds Associates

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The combined role of chief executive and board chairman for American corporations has the weight of corporate history and clear reporting lines on its side. However, separating the roles to give the board its own independent chair is now a strong business trend, and is encouraged by many activist investors. Which is best for your company? Carefully weigh your corporation's needs.

Should the roles of chairman and CEO be separate? That is the question that many who serve on boards of directors are debating as they search for the optimal structure for corporate governance.

We face a backdrop of a challenging economy, increased regulation as well as rising investor discontent. Shareholders and corporate directors are thus considering whether one executive, no matter how skilled, can effectively and objectively handle the mounting demands of both management and governance.

The issue of separating the roles of chairman and CEO has come before a number of companies of late including JPMorgan Chase, Chesapeake Energy, Avon Products, Goldman Sachs and several others. In some cases, it has been a result of routine debate by the board. In others, it is driven by pressure from frustrated shareholders and activist investors.

Traditionally, in the American corporation, the same executive held the roles of chairman of the board and chief executive officer. It was believed that the executive under such a structure would possess multiple perspectives as well as the power to quickly enact corporate initiatives. However, critics of this form of corporate governance have come to believe that it allows little transparency into the CEO's actions, and as such these can go unmonitored, paving the way for conflicts of interest and corruption.

With a single executive holding both titles, it has been argued that the company's entire decision-making process lies in the hands of one person, with little in the way of checks and balances. In essence, the CEO has absolute authority and, if the CEO also chairs the board, it might be difficult for that board to objectively evaluate his decisions and performance.

In the aftermath of major corporate scandals, as well as the enactment of regulations such as Sarbanes-Oxley and Dodd-Frank Act, an increasing number of companies have separate executives holding the chairman and CEO titles. By maintaining separate roles, the two executives can focus on key aspects of running the enterprise, with the CEO focused on the day-to-day operations of the company while the chairman is involved with overseeing regulatory compliance, recruiting board members, as well as the critical issue of succession planning.

Board members now place a priority on maintaining their independence from the CEO, and the trend toward separate roles continues to gain traction.

According to research conducted by Russell Reynolds Associates, a record 44 percent of S&P 500 companies now have separate executives holding the chairman and CEO roles. This is a marked increase from seven years ago when 29 percent of companies had such a corporate governance structure, and 21 percent with separate roles in 2001. Similarly, analysis shows that 62 percent of companies in the NASDAQ 100 had split CEO and chairman roles in 2011 compared to 45 percent with split roles in 2005.

This survey also revealed that board members are placing a priority on maintaining their independence

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from the CEO, and increasingly advocate that the chairman and CEO roles be separated to promote a balance of power. While this trend is more established in Europe (where more than 90 percent of FTSE 100 companies have long had distinct roles), it is clear that companies in the United States are increasingly following suit.

The trend towards separate roles continues to gain traction among some of the nation's leading companies. Earlier this year, Thomas J. Engibous, an outside board member of J.C. Penney Company, became the first independent chairman of the department-store chain. He succeeded retiring executive chairman Myron E. Ullman III, who served as CEO until turning over the reins last year to former Apple retail stores head Ron Johnson.

As more boards split the CEO and chairman roles, the relationship between chairman and CEO becomes even more crucial.

In November 2011, Apple named outside director Arthur Levinson chairman, filling a spot briefly held by late co-founder Steve Jobs (Apple did not have a chairman while Jobs was CEO). Finally, while JPMorgan Chase chairman and CEO Jamie Dimon retained both titles despite a recent shareholder proposal to separate them, a number of the largest U.S. bank holding companies, Bank of America and Citigroup have separate chairmen. Bank of America split the positions after shareholders backed the move in 2009 in the wake of the company's acquisition of Merrill Lynch and Co.

Whether in the U.S., Europe or any other region, corporate governance experts agree that the critical goal is to establish the best working relationship between the CEO, the chairman, and other directors. As more boards split the CEO and chairman roles, the relationship between chairman and CEO becomes even more crucial.

Gerard Kleisterlee, non-executive chairman of global telecommunications giant Vodafone and a member of Dell's board, believes that the CEO and chairman determine the climate in the board and its interaction with management. "There needs to be an open and constructive relationship with room for criticism and feedback. When openness thrives, the CEO and his executive team not only seek advocacy and support from the board, but sometimes come with their questions and their doubts. That sort of corporate governance helps eliminate mistakes and enables great management execution."

While most of the arguments in favor of separating the chairman and CEO titles focus on good governance practices, there is another, more practical factor to consider: cost. A study by GMI Ratings reveals some interesting facts. In their study of 180 major North American corporations with $20 billion or more in market capitalization, GMI found that in those companies in which a single person holds the combined titles he or she earns median pay in excess of $16 million. This compares with the $11 million compensation for those who only hold the CEO title.

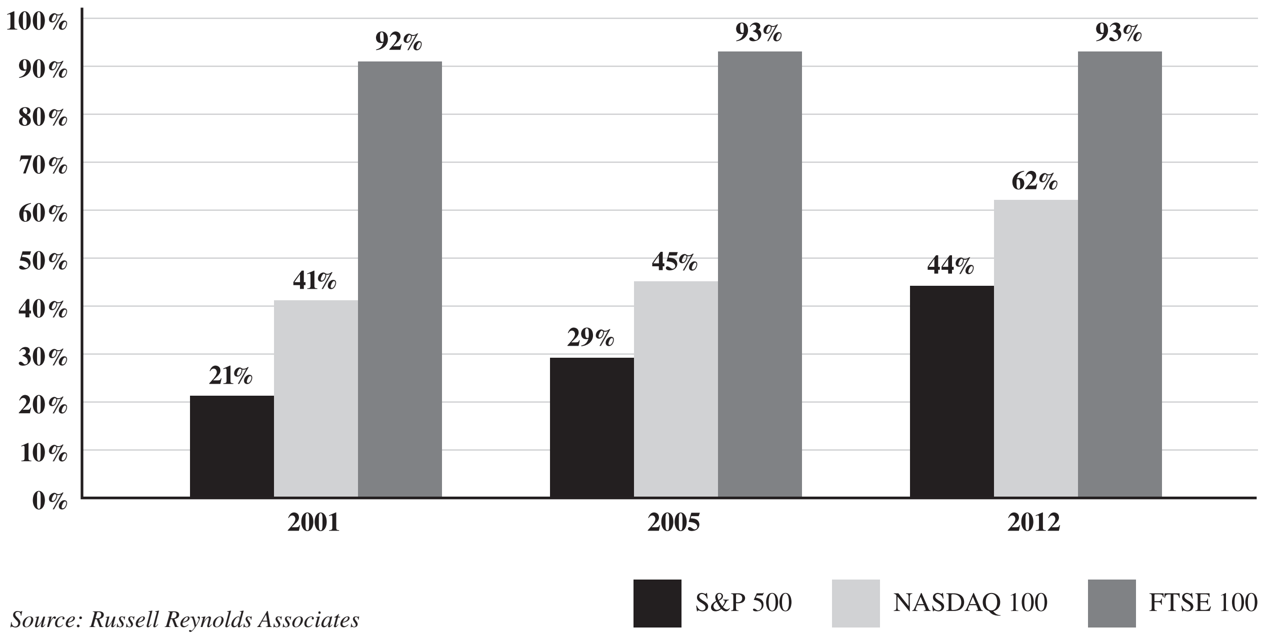
The study by GMI Ratings reveals other interesting insights that weigh in favor of splitting the chairman and CEO titles. Chief among these is the fact that companies with combined CEOs and chairmen appear to present greater risk for investors, and provide lower stock returns over the longer term than companies with separate roles. Their research indicates that, over a five-year period, companies with separate positions generated a 40 percent return to shareholders, compared with a 31.3 percent return to those companies in which a single executive held both titles.

There is no "one-size-fits-all" approach for the CEO-chair issue. No single structure works for every corporation.

What factors determine whether a company should split its CEO and chairman roles or combine them? This is an increasingly important question that no board of directors should ignore. At a time when corporate performance is as highly scrutinized as ever—by shareholders, regulators, and even employees—proper governance can no longer be taken for granted.

A Growing Divide

Percent Of Companies That Split Chair And CEO Roles



Source: Russell Reynolds Associates

However, there is no "one-size-fits-all" approach for the CEO-chair issue. No single structure works for every corporation. Each organization is unique, its circumstances different. When deciding to split the roles, each board must decide on an appropriate governance model based on the specific characteristics of the board and the company's situation.

While the call for separate chairman and CEO roles is growing, the results of actual shareholder votes on the issue are mixed.

It is prudent to acknowledge that there have been marked changes in corporate governance during the past few years with an emphasis on the need for companies to be governed by independent boards. However, it should also be considered that boards themselves are in the best position to define the structure that suits their companies.

While the call for separate chairman and CEO roles is growing, it might be interesting to look at how shareholders vote at annual meetings. As noted earlier, JPMorgan Chase chairman and CEO Jamie Dimon retained both roles by a rather decisive margin at the company's 2012 annual meeting. Shareholders voted only 40 percent in favor of a nonbinding proposal to split the positions. The vote came on the heels of the banking giant's $2 billion trading loss and decline in stock price. In addition, the proposal to separate the titles at JPMorgan Chase had the support of two major proxy advisory firms—Institutional Shareholder Services and Glass Lewis.

JPMorgan Chase notwithstanding, the trend among corporate governance experts to recommend the appointment of separate CEO and chairman roles has produced results among large banks, including Bank of America and Citigroup. However, industrial manufacturers, such as DuPont, General Electric and AT&T have kept their CEO and chair roles combined, while similar proposals were defeated at defense companies Lockheed Martin and Northrop Grumman.

One of the chief functions of a board of directors is to serve as a fiduciary to the shareholders of the company. It is the responsibility of the board to act on the behalf of shareholders to provide independent oversight of publicly-traded companies' management and operations. Corporate scandals at News Corp., as well as companies that have incurred the wrath of unhappy shareholders, are raising awareness of the importance of independent board oversight. As a result, the movement calling for public companies to split the roles of chairman and CEO is gaining momentum.

Clearly, the call to split the roles of chairman and CEO comes as a result of directors reacting to shareholder demands to improve corporate governance and enhance shareholder value. In today's volatile marketplace, yesterday's winners can easily become today's losers, and shareholders, empowered by changes in proxy regulations, are demanding results.

With the shares of Avon Products tumbling last year, investors pressured the board to make a change at the top. By December, the board announced that it would search for a new CEO to replace Andrea Jung. In April, the direct marketer of health and beauty products hired Sherilyn S. McCoy from Johnson & Johnson to serve as CEO, and retained Jung as chairman. The move means that for the first time in 11 years, Avon has two different people serving in the two slots.

Facing the ire of noted shareholder activist Carl Icahn, natural gas producer Chesapeake Energy Corporation opted to revamp its corporate governance structure. In addition to appointing five new independent directors, the company named Archie W. Dunham, former chairman of ConocoPhillips and former CEO of Conoco, as Chesapeake's new non-executive chairman. Chesapeake's cofounder, Aubrey K. McClendon, relinquished the position of chairman but remains a director and continues to serve as Chesapeake's chief executive officer and as president.

Leading to the changes at the company were accusations that McClendon had engaged in practices deemed to be a conflict of interest. "We believe separation of the chairman and CEO roles will improve Chesapeake's corporate governance … which should send a positive signal to the market and improve shareholder value," a Chesapeake director said.

If there is no obvious conflict of interest, a board might arrive at a different conclusion. Sometimes having just one person at the helm is the right call. That is what Goldman Sachs' board concluded, but with a slight wrinkle. The American Federation of State, County and Municipal Employees had been pushing the investment banking giant to divide the responsibilities held by its chairman and CEO, Lloyd Blankfein.

The bank believes that Blankfein is the man for both jobs, so in March 2012 the board announced a plan to create a "lead director" position. This prompted the union pension fund to withdraw its proposal. While Blankfein retains both titles, he will share power with the lead director, who will oversee corporate governance processes.

Companies with a separate CEO and chairman believe that an independent chair acts as an impartial resource for the board to express its views on management's decisions, thus allowing the board to fulfill its regulatory obligations. While this is true, the same result can be achieved through the appointment of a non-executive lead director, who is independent and experienced and can reflect the board's positions in a forthright and constructive manner—especially when they are contrary to management's.

External pressure should not be what causes a board to look at its leadership. Assess leadership as part of an ongoing succession process.

Critical to the success of any corporate governance structure is the ability to maintain independent and objective oversight. The best time to do this is well ahead of a crisis, or having outside forces dictate the governance model. External pressure should not be what causes a board to look at its leadership. It is prudent to embed the assessment of the CEO-chairman split within the context of a board's ongoing succession planning. There is no better time to assess the leadership structure than while planning for an executive succession. As most high-performing companies understand, succession planning is an ongoing process.

As the board reviews its options and the candidates for its CEO and chairman positions, it might conclude that it is best to appoint one experienced executive to handle both roles. That might have worked in years gone by. However, in today's environment that is by no means a given. Each company has to be examined through a different lens as circumstances and the environment change. In addition, the size of the enterprise needs to be considered. Boards must also weigh the culture of the corporation. Separating the CEO and chairman jobs may create confusion about who is leading the company, particularly in times of transformation and/or crisis.

Consider Cardinal Health, the giant medical supply and distribution company based in Dublin, Ohio. During the spring of 2010, following a sweeping, three-year corporate reorganization, Cardinal was left in the hands of George Barrett, a 25-year industry veteran. Barrett had been appointed chairman and CEO of the new Cardinal, but shareholders, still unsure about the company's prospects in a turbulent economy, voted for Cardinal to separate the roles. A split would have had short-term appeal, but the board was concerned that it might not be in the best interest of the company over the long term.

It appears that Cardinal Health's board acted prudently and weighed its options carefully. It decided Cardinal needed stability at the top to keep the company moving forward. "It was so important for us to have alignment between the board and the management on where we were going, on the design of our strategy, even on some of the rethinking about what the board should look like," Barrett told us in an interview. "So we felt that combining those roles provided alignment."

While the board rejected the shareholder proposal for a split, the company has been performing well and appears to have gained the confidence of shareholders. At Avon, the circumstances were very different. Unlike Cardinal, Avon's Jung had been at the helm for more than a decade as chairman and CEO. While she presided over a period of strong growth, the company's performance had slowed. By hiring Sherilyn McCoy, the board brought in someone who could provide a fresh perspective. The board realized McCoy can also benefit from the vast experience and industry knowledge Jung has accumulated during her tenure. In this case, it makes sense for the CEO and chairman roles to be split, but retain continuity with Jung retaining the chairman's title for the next two years.

To perpetuate the success and culture of a company, directors must weigh the best governance structures to accomplish those goals while serving the needs of diverse constituents.

Today's corporate structure may not work tomorrow given the changing regulatory environment and uncertain economic conditions. Companies and their boards are coming under increasing scrutiny over succession planning, particularly at those companies led by high profile CEOs. To perpetuate the success and culture of the enterprise, directors must weigh the best governance structures to accomplish those goals, while serving the varied needs of the company's diverse constituents.

When assessing the performance of the CEO and chairman, succession planning is an ongoing responsibility. The key is to weave the notion of a split or combined CEO/chairman role into the succession discussion. There is, after all, no doubt that it has become a permanent part of the governance conversation.

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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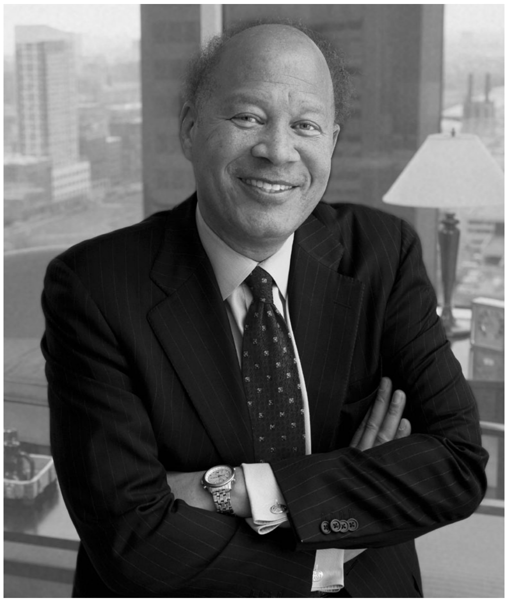

Charles A. Tribbett III

Charles A. Tribbett III focuses on senior level assignments, such as CEO, President, Executive Vice President and general management positions across industries. He specializes in board services assignments and has conducted CEO assignments, board searches, succession planning and executive assessment projects for leading international corporations. Charles has also led numerous diversity assignments for companies across all industries. He co-leads the firm's CEO and Board Services Practice in the Americas, and is an expert on succession planning, board selection and diversity recruitment.

Recent Client Experience

Handling assignments spanning the firm's six sectors, Charles has conducted some of the most notable projects in the search industry. He has advised and led many of the largest Fortune 100 CEO searches in the nation. His experience crosses over financial services, technology, consumer, healthcare and manufacturing

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Prior to joining Russell Reynolds Associates, Charles worked for a number of years as a corporate securities attorney with the Wall Street firm of Skadden, Arps, Slate, Meagher & Flom.

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