DECLARING INDEPENDENCE

More large companies are splitting the board chair and CEO roles. But there are other ways to counterbalance a strong executive.

By Reva Nelson

Tesla and Allergan are very different companies. But they do have something notable in common: Both recently separated the roles of CEO and board chair. In September, Tesla CEO Elon Musk relinquished his chair position for at least three years as part of a settlement with the U.S. Securities and Exchange Commission. And in March, pharmaceutical giant Allergan agreed to split the role in two after pressure from an activist hedge fund frustrated with the company's stock performance. (The split will take effect only after the tenure of its current CEO-chair, however.)

These examples underscore that companies have unique reasons for the shift in governance structure. But the overall trend is clear: More large companies are choosing to end "duality" and split the two roles.

In Europe, this has been the norm for some time. Only 9.2 percent of Stoxx Europe 600 companies had dual CEO and chairman roles in 2018, down from 11 percent in 2013, according to data compiled by ISS Analytics for *The Wall Street Journal*. It appears European habits are gaining traction stateside too: S&P 500 companies whose CEOs also serve as chair declined from 48.7 percent in 2017 to 45.6 percent in 2018, the lowest percentage in at least a decade, according to ISS Analytics data.

What is driving this change? One obvious reason is CEO improprieties. Similar to Mr. Musk's role change at Tesla, French automaker Renault SA named a new split leadership structure in January, following CEO Carlos Ghosn's arrest on charges of financial misconduct.

More is at play than executive missteps, though. In the U.S., the shift may be driven in part by the changing regulatory landscape. In 2002, the Sarbanes-Oxley Act required stricter corporate governance regulations and an independent audit system that made the CEO's place on the board more fraught. In 2010, the Dodd-Frank Act required U.S. public companies to articulate in their proxy statements why their board chair and CEO positions are dual or split.

There are practical reasons for a split: A company might want to enable both the CEO and the chair to maintain a focus on distinct issues, or benefit from the skill sets and perspectives of two different leaders. And corporate governance experts say keeping the roles separate can improve oversight and decision-making.

WHAT DO STAKEHOLDERS WANT?

Many corporations are also spurred to adopt a split governance structure by external stakeholders demanding greater transparency and influence over the direction and operations of the organization.

CACI, a Fortune 1000 professional services and IT company, decided to split its chairman and CEO roles in 2001. "We had just reached $1 billion in market capitalization, and we realized that to become a $10 billion organization we had to undergo a lot of change," says Warren Phillips, lead director of CACI. The company decided it would be best to separate day-to-day management responsibilities from higher-level oversight issues. Mr. Phillips, who was named to the National Association of Corporate Directors Directorship 100 in 2018, was also chairman of Labock Technologies.

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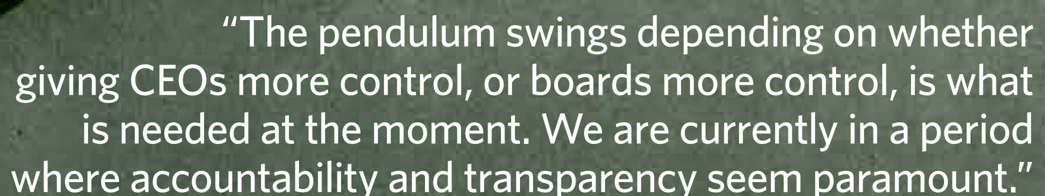
us to focus on the social, environmental and governmental issues that have become so much more important in the modern era of corporate governance," Mr. Phillips says. "Enabling the board to focus on these issues makes our company stronger."

The importance of this broader array of issues is growing as the voices of various stakeholders grow louder. "With unemployment improving across the globe, workers, not just shareholders, can and will have a greater say in defining a company's purpose, priorities and even the specifics of its business," Larry Fink, CEO of BlackRock, wrote this year in his annual letter to CEOs.

From hiring practices to gender equity to climate change, stakeholders have more to say than ever about management's priorities. With these issues likely to take up more space in boardrooms in the coming years, splitting the roles of running the board and running the company can be an effective way to ensure everyone's voices are heard.

"The board needs to be prepared for the growing involvement of shareholders and stakeholders expressing opinions and desires," Mr. Phillips says. "A key issue boards now oversee is the need to achieve financial objectives in a way that shareholders and stakeholders feel is appropriate."

Of course, many shareholders have been making their desire to split the CEO and chair roles clear for a while now. Year after year, companies including Chevron, Exxon Mobil and Walmart see shareholder proposals with this goal. Often driven by institutional investors unhappy with financial performance or others pushing for a change in executive pay practices, they are virtually always unsuccessful. In 2017, 38 companies in the Equilar 500—the 500 largest companies by revenue trading on a major U.S. stock



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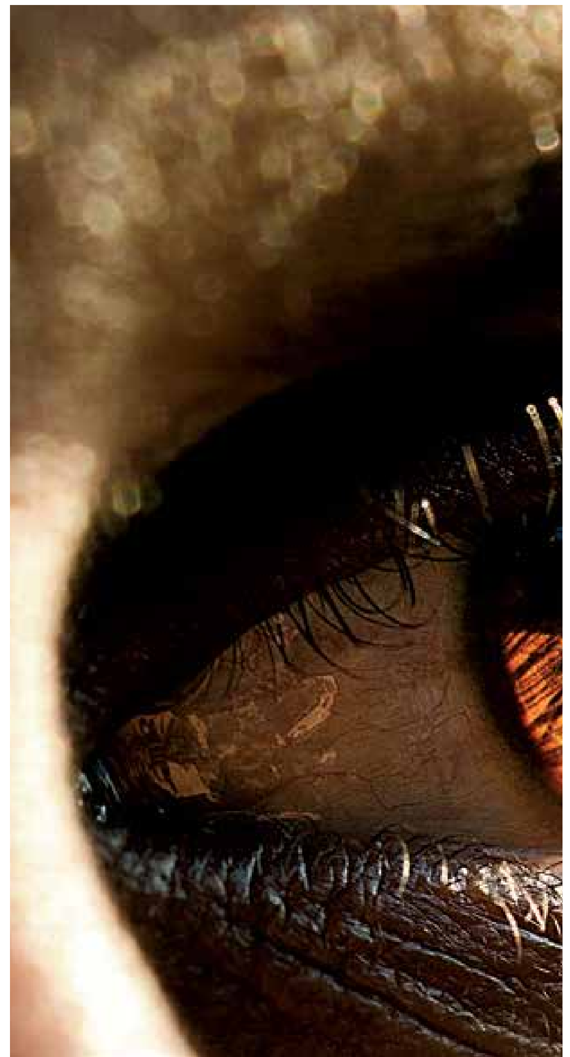

exchange—received a shareholder proposal to create an independent chair. All 38 proposals were rejected.

SAME GOAL, DIFFERENT TACTICS

Not everyone agrees that it is universally better for companies to split the board chair and CEO roles. Robert M. Wiseman, a professor at Michigan State University's Broad College of Business, sees an ebb and flow to the trend from a long-term perspective. "There are arguments for and against duality, but research on it is mixed at best," he says. "The pendulum swings depending on whether giving CEOs more control, or boards more control, is what is needed at the moment. We are currently in a period where accountability and transparency seem paramount."

David F. Larcker and Brian Tayan of Stanford University's Corporate Governance Research Initiative also note that the evidence to support the value of separate CEO and chair positions is relatively inconclusive. "Most research finds that the independence status of the chairman is not a material indicator of firm performance or governance quality," they wrote in a 2016 research article. While advantages include better oversight and fewer conflicts of interest, Mr. Larcker and Mr. Tayan also point to drawbacks like duplication of work and impaired decision-making during crises.

Boards can and should act in other ways to assert themselves in the face of a powerful executive or to make sure they are responsive to stakeholder concerns. For example, boards can review and strengthen the company's internal whistleblower mechanism. They can review CEO expense-reporting policies. Most of all, they can look in the mirror to ensure they are not unduly deferential to management or even disenfranchised by it.

Regular evaluation helps keep boards on top of their game, says Peter Swabey, policy and research director at ICSA: The Governance Institute.

"Most of us as part of our daily working roles have a boss who gives us feedback. Boards need this, whether that is through self-evaluation or from independent professional experts," he says. "Evaluations give directors an opportunity to not only reflect on what they could be doing

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better individually and as a board, but also benchmark themselves against other boards."

Boards increasingly recognize that by soliciting a diversity of views, they can act as a better foil to challenge and improve the management team. "In the past, directors were all from the same golf club or the same school," Mr. Swabey says. But today, "there is a much stronger focus on the specific skills a new director is bringing into the boardroom. More boards are asking: Will this person have a different enough background and mindset to challenge what is being presented by management?"

Another way to breed board independence is to hold independent-director sessions apart from full board meetings. "It's important to have an independent director-only session as a part of each board meeting," Mr. Phillips says. During this time, "each one of us picks up on different information from across the business. It helps us have a clear picture of where there may be areas that require more attention."

Meeting with key institutional and other investors prior to proxy season, which Mr. Phillips does at CACI, is an important information-gathering session for directors. These types of meetings, which are increasingly common, typically include directors and executives. "These preproxy meetings are probably the healthiest place for direct expression of many of the issues the board needs to consider. It helps the board get a sense of whether or not there's something wrong," Mr. Phillips says.

CACI's board also keeps an eye on stakeholder issues and other risks through its culture committee (which oversees stakeholder and employee concerns), investor relations committee and strategic assessment committee. The point is to open windows into the company so the board is not myopically seeing only the CEO's version of reality. "We're always looking at qualitative and quantitative evaluations that we do on a regular basis, in conjunction with management," Mr. Phillips says. "When we see trends that are going the wrong way, we increase the dialogue." **IQ**

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