Splitting Up the Roles of CEO and Chairman: Reform or Red Herring?

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There may be good reasons, based on specific circumstances, for companies to divide the roles of CEO and chairperson between two people. But Wharton faculty members say there is no evidence that separating these positions, as a general philosophical rule, improves corporate performance.

Many advocates of improved corporate governance assert that the posts of CEO and chairperson should not be held by the same individual because such an arrangement concentrates too much power in the hands of a single executive, leading to potential CEO entrenchment and poor bottom-line performance. The many corporate scandals that have unfolded since 2001 have added impetus to this view, even though there were separate CEOs and chairpersons at WorldCom and Enron when wrongdoing engulfed those companies.

Figures show that a growing number of companies are dividing the jobs of CEO and chairperson, but the trend is not widespread. In March, the Corporate Library, a good-governance advocate, published the results of a survey showing that the same person holds both posts at most American companies -- 377 of the corporations in the Standard & Poor's 500 index. That is 17 fewer companies than the year before.

"In terms of splitting the roles, there is no academic evidence to suggest that it's a good thing," says finance professor Andrew Metrick. "What we do have evidence for is that it's important for the CEO to realize that he is reporting to the board and not controlling the board completely." Many researchers have looked at this issue, Metrick adds, but it has been impossible to reach a firm conclusion that financial performance is improved by splitting the roles. "Most of the dynamics that we'd really like to capture are just not that easy to see in the data. People tend to focus on board independence, but board independence is a very squishy concept."

Metrick says that the emphasis on having separate CEOs and chairpersons is largely a "red herring" because board independence can be accomplished in other ways, such as directors holding meetings without the CEO being present.

"Everyone's struggling to come up with metrics for corporate governance," says accounting professor David F. Larcker. "There are a lot of governance scorecards [compiled by shareholder advocacy groups], but governance is inherently very difficult to measure. One measure that's gotten lots of publicity is splitting the chair and CEO roles. My feeling is, for most cases, it's nice window dressing but not substantively a big deal."
Management professor Michael Useem, director of Wharton's Center for Leadership and Change Management, says a few statistical studies have compared companies where two persons hold the CEO and chair positions with companies where one person holds both posts. This research, which also took into account other factors that can affect financial performance, shows that whether a company does or does not separate the CEO and chairperson titles "has no bearing on corporate financial performance," he

notes.

Robert E. Mittelstaedt Jr., vice dean and director of Wharton Executive Education, says experience shows that it is difficult to make the argument that dividing the two roles will result in better performance in all cases. “There’s no one black-and-white answer to fit all situations,” he explains. “Many people would believe that, if nothing else, you diffuse power to some extent and decrease the probability of a scandal by separating the chairperson and CEO positions. But that doesn’t mean you will have great business results.” Indeed, by dividing those roles, a company may weaken its ability to develop and implement strategy. “I’m not saying that’s always going to be the case, but boards have to carefully consider the issue” before voting to split the chairperson and CEO roles.

Some high-profile firms have recently decided to divide these roles, for any number of reasons. Tom Siebel has relinquished the CEO title at Siebel Systems to former IBM executive J. Michael Lawrie. Disney shareholders stripped embattled Michael Eisner of his chairman’s title and gave the job to George Mitchell, a former U.S. senator. Michael Dell has said he will soon turn over the CEO position at Dell Computer to chief operating officer Kevin Rollins. At Oracle, CFO Jeff Henley has been named chairman, with Larry Ellison remaining CEO. In an earlier, well-publicized case, Microsoft chairman and CEO Bill Gates turned over the chief executive reins to longtime colleague Steve Ballmer in 2000.

There have been recent exceptions to this trend, however. Scott McNealy, chairman, CEO and president of Sun Microsystems, said that Jonathan Schwartz would become president and COO, but not CEO. In addition, Coca-Cola's board rejected a proposal to divide the CEO and chairperson’s jobs.

The Wharton experts say it should not be surprising that one individual holds the positions of chairperson and CEO at nearly four-fifths of big American companies because that has long been the tradition, unlike, say, in the United Kingdom, where non-executive chairpersons are the norm. Indeed, the Wharton people say, a typical executive applying for the position of CEO at a U.S. company would not take the job unless he or she could also be chairperson.

There are many reasons, aside from attempts to improve governance, for companies to choose to divide these roles. “If you’re under the gun for bad governance or your performance has been flat or declining, it’s a simple matter to split those roles, and maybe that pacifies people to get them off your back for a while until you straighten things out,” says Larcker.

Boeing, GM and eBay

Useem agrees that dividing the roles can help turn companies around. In light of the recent scandals and the ensuring governance guidelines issued by the New York Stock Exchange and the National Association of Securities Dealers, “there is a far more compelling case to be made these days for a separation of those two roles.” But, going forward, he says that most companies that separate the roles will do so because they are troubled or facing a major executive succession challenge.

As an example, Useem points to Boeing, where in December 2003 chairman and CEO Phil Condit was forced out and two people were named to replace him: Harry Stonecipher was named president and CEO and Lew Platt, one-time chairman and CEO of Hewlett-Packard, was appointed non-executive chairman. The board of General Motors made a similar change when the company was struggling in 1992 by replacing its chairman and CEO with two people. A couple of years later, when GM's performance had improved, the two titles were once again given to one person.

"The GM case is a good summary of my main point," Useem notes. "On average, it's neither here nor there in terms of financial performance if a company separates those roles. But when companies are distressed, the market looks for a separation of those two roles as a sign of good governance or certainly a commitment to restore lost luster and the earnings that go with that."

Often, separating the two roles makes sense when companies are not experiencing any difficulties. At eBay, company founder Pierre Omidyar is non-executive chairman and Meg Whitman serves as CEO. "That's a company that's not ever been in trouble," says Useem. "Like any good non-executive chairman of the board, Omidyar is there for thinking strategically and for advising Meg Whitman, who runs that shop extremely well. Under some conditions, having a separate chairman may reflect the peculiar history of a company and the willingness of a founder to stay involved."

Another occasion when it may make sense to split the two roles is when a new chief executive has been named. In such cases, it is not uncommon for the outgoing chairman/CEO to stay on for a time in the sole role of chairperson until the new person gets his sea legs. "That just makes the transition easier, to make sure the person coming into the job is up to speed on things," explains Mittelstaedt.

Mittelstaedt adds that there are times when splitting the roles may not actually diminish the role an executive plays. "Whenever you have a company where the founder is still in the company, like Siebel, he may have given up the CEO title, but don't kid yourself, he's still running the place," says Mittelstaedt. "That's a split in name only because his personality is such that he is unlikely to stay out of it. It's similar to Microsoft. Gates and Ballmer split roles, but they had been a team for a long time and they're still a team. The split changed responsibilities, but Gates still plays a day-to-day role, especially in product development."

A Sounding Board for the CEO

Despite the lack of hard evidence that separating the roles boosts returns to shareholders, it is worthwhile for companies to consider doing just that, according to John Percival, adjunct professor of finance. "If I'm a shareholder, I don't think I want the CEO of my company to be chairman," he says. "I think boards should represent the interests of the shareholders of the company ... The chairman of the board should ask some important questions about why the company is doing what it's doing and should act as a sounding board for the CEO."

But Percival wonders whether there are enough experienced people available to perform the role he envisions for a chairperson. "It takes a really special person who has experience in running a business, hopefully a similar business, where he can provide the right kind of counseling and has the credibility to be accepted by the rest of the board as a leader. I just wonder where you find those people. Being a skeptic is an important role for a chairman -- not cynical but skeptical, a person who doesn't just fall in line with the CEO's vision. Leaders don't like to have their vision questioned. The perfect way to achieve that is to be both chairman and CEO." Percival says that if the right individual cannot be found to serve as a strong, independent chairperson, a company "might be better off having the CEO be chairman of the board."

In years to come, the issue of dividing the CEO and chairperson's roles may take on less importance as boards of directors adopt other ways of strengthening their independence to give them the ability to go head to head with hard-driving CEOs, according to accounting professor John Core.

"Regulations are moving toward having [increased] oversight by independent boards of directors so that the spirit of splitting the CEO and chairperson roles can be achieved in other ways," says Core. "If keeping the chairperson and CEO jobs separate allows directors to be independent, then that's certainly helpful. But other developments are making this less important. For example, the New York Stock Exchange and NASDAQ have started to require that outside directors meet separately. These regular meetings of outside, non-management directors have the effect of splitting the board chairperson and CEO positions because they let non-management directors set their own agenda and have independent oversight of the company. It's not so clear to me that it was important to have a separate CEO and board chairperson to begin with. As these rules get stronger, it may be [even less important]."

Larcker and Useem predict that only a small number of large companies will divide the CEO and chairperson posts in the future. "I think the tradition is so strong that those are mutually held positions for big companies," Larcker says. "A separation of roles would almost have to be mandated [by regulators] before you'd see a big shift." Adds Useem: "I'd be surprised to see [many more S&P 500 companies] having those roles separated out. In the culture of U.S. corporations, people would question the implicit lack of confidence in a CEO who was not given both titles."