THE REALITY OF DUALITY ON CORPORATE BOARDS

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Many investors have questioned whether CEO duality weakens corporate governance. In our view, CEO duality—which occurs when a company’s CEO also serves as board chair—has pluses and minuses, but overall it is less desirable than splitting the roles because it reduces CEO oversight. It may also dampen useful perspectives that differ from the CEO’s, as well as have a negative effect on internal capital-allocation decisions.

A separate chair provides a check and balance to a CEO’s authority and creates a bulwark against risky decision-making from a CEO that may harm a company in the long term. Separation also removes the inherent conflict of interest that could arise from a dual role, in that the board of directors makes decisions on compensation and succession that could impact the CEO. In general, the board has no privacy in duality structures to discuss the CEO (unless a lead independent director convenes a meeting of the board members), and in certain matters, board members may be reluctant to make helpful suggestions that the CEO could frown upon.

Over time, the proportion of companies that split the roles of CEO and board chair has increased [see table]. This is partly due to regulatory changes. The Sarbanes-Oxley Act of 2002 required public companies to conform to rules such as creation of an audit committee of independent directors, meant to increase board independence. Also in 2002, the New York Stock Exchange (NYSE) Board of Directors approved changes to listing requirements. With the changes, the NYSE detailed what it considers “independent” and shortened the compliance date for the existing requirement that a board have a majority of independent directors, among other changes. The SEC further enforced independent board rules in the Dodd-Frank Act. In aggregate, these regulations pumped the brakes on the era of the “Imperial CEO” and the cronyism evident in many pre-crisis boards.

An increase in institutional ownership relative to retail ownership is also partly to blame for the trend toward splitting the roles of CEO and board chair. Institutions owned 82 percent of shares in the S&P 500 Index in 2014 versus 73 percent in 2004, per S&P Capital IQ. Institutional shareholders have required more shareholder-monitoring devices, such as strong boards and board leaders to act as the voice of shareholders and to keep company management in check. Also, the rise of activist investors has pushed more independent board members into influential positions on boards.

Despite the trend toward splitting the roles of CEO and board chair, many companies still have the roles combined. For example, Bank of America Corp. combined the board chair and CEO role of company leader Brian Moynihan in October 2014, reversing a bylaw that was approved by investors in 2009, and soon faced backlash from investors. Both Bank of America and JPMorgan Chase & Co. continue to have dual roles in place. However, Wells Fargo & Co. took the opposite track in late 2016 when the company decided to amend its bylaws and split its chair and CEO roles after facing fallout from a scandal over its sales policies. Caterpillar Inc. also decided in late 2016 to split its chair and CEO roles. Market analysts speculated that the
separation was made, in part, in response to falling sales and to the previous CEO/chair’s decision to pursue a major acquisition that proved unsuccessful.

INDEPENDENT LEAD DIRECTOR VERSUS NON-EXECUTIVE CHAIR

For firms that have CEO duality in place, it is possible to have an independent lead director on the board to potentially counterbalance the CEO and other executives, and to help to create an environment in which the board can act independently. The prevalence of a lead independent director on corporate boards has increased since 2003 (see table). However, unlike a non-executive chair, the independent lead director is an informal role that may not command the longevity or internal or external respect of the formally appointed chair. In terms of strong CEO oversight, we believe that a formally appointed non-executive chair is preferable.

THE CREDIT RESEARCH PERSPECTIVE

Using environmental, social and governance (ESG) information from MSCI and Sustainalytics, board independence is factored into our internal ratings of each corporate credit in our coverage universe. When a company has a combined CEO/chair, MSCI flags it as a governance concern in its research and weighs this issue with other key governance indicators to evaluate a company’s governance practices. Sustainalytics scores each of its ESG indicators individually before aggregation into total ESG category scores. For example, if a company’s CEO and chair roles are separated, Sustainalytics awards full points to the indicator, which would have a favorable effect on the company’s total governance score.

We realize that CEO duality can also benefit companies in certain ways. For example, a dual CEO/chair offers one merged voice for the company that reduces confusion by delivering a unified tone, and serves as a central person who can be approached with questions by the board. In addition, a dual role prevents any imbalance in the information provided to the CEO or the chair.

That said, ultimately a company’s corporate governance structure should help it to operate sustainably in the long term. CEO duality, board independence and related risks remain important considerations in our ESG research.

5. New York Stock Exchange, as of March 1, 2017. Companies must satisfy the majority independent board requirement of Section 303A.01, if applicable, within one year of its listing date on the NYSE.
6. “The Sarbanes-Oxley Act of 2002,” https://www.sec.gov/about/laws/soa2002.pdf?_sm_au_=iVn3DBq5Bws9rp3. To be considered “independent” per the Sarbanes-Oxley Act, other than in his/her capacity as a member of the audit committee, the board of directors or any other board committee, a board member cannot accept any consulting, advisory or other compensatory fee from the company or be an “affiliated person” of the company or its subsidiaries. “Affiliated person” is defined in the SEC Investment Company Act of 1940.

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