

Appendix 6

The Chairman/CEO Separation: One View

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What can American boards learn from the British? The need to bring back into balance a relationship that has become seriously unbalanced.

Americans have long taken it for granted that the US leads the world in the techniques and practice of management – they were, after all, pioneers in formal management and business education, and in professional management consultancy – and therefore had little to learn about management from other countries. This assumption may have been generally valid until, say, the early 1970s, but in more recent years, other countries have clearly overtaken us.

One particular area of corporate management in which another country, namely the United Kingdom, has, I think, made greater progress than we have in the US is in what now is commonly called “corporate governance.” While this has been and continues to be the subject of much debate in the US, much of this seems to center essentially on constitutional or legalistic issues: the rights of shareholders, the relationship between the board and management, the locus of decision-making on certain key issues (e.g. executive compensation, appointment of directors, strategic options), the accountability of directors to other stakeholders, and so on.

One important sub-issue within this larger debate concerns the separation of the roles of chairman and chief executive, which even now is far from being resolved. It is on this point that I believe we may be able to learn something from the UK experience.

The starting point for that experience was for me a conference held in London in 1972, co-sponsored by the British Institute for Management and McKinsey & Co., on the subject of “Effective Boardroom Management.” That conference, for which I acted as chairman, was attended by 20 chairmen and senior executives of major UK public companies. This event focused attention for the first time on what had previously been a virtually taboo subject: the performance (or not) of

public company boards, chairmen, and directors. From this there then followed a slowly but steadily increasing flow of studies, surveys, articles, and seminars on the duty and responsibilities of public company boards of directors. These culminated in the publication last year of the Cadbury Commission on *The Financial Aspects of Corporate Governance*.

The Cadbury Report commended a “Code of Best Boardroom Practice” that embodies a number of significant changes in traditional UK boardroom composition and processes. This Code has now been adopted by the London Stock Exchange, and companies listed on that exchange are now required to state in their annual reports the extent to which they have complied with each of the Code’s provisions. Noncompliance will have to be explained.

I myself have been closely identified since the 1972 conference in London with the evolution of boardroom thinking and practice in the UK and have made some contributions to it – for example, my *Letters to a New Chairman*, first published by the Institute of Directors in 1979 and revised and re-published in 1990. So, from that perspective, what do I see as the lessons in corporate governance that might be learnt by US companies from the UK experience? I believe that there are at least three, the second and third of which follow logically from the first.

- 1 Re-affirmation of (a) the already established fiduciary role and legal authority of the board of directors as the crucial interface between the company’s owners (shareholders) and its CEO and management, and (b) the board’s direct accountability to the former for the performance of the latter.
- 2 Recognition and restoration of the key role of the board’s chairman as the architect and leader of a strong and independent board that is capable of fulfilling its established fiduciary duties and responsibilities.
- 3 Appointment by the board of a chief executive who is competent to lead and manage the company effectively, but who is ultimately subordinate and accountable to the board for doing so – and subject to removal by the board if he fails.

THE BOARD

Over the years many UK and US boards of directors – even of some very large and seemingly successful companies – appear to have abdicated or neglected their full fiduciary responsibilities and, either by design or by default, have delegated these to increasingly powerful CEOs. While it may not be possible to demonstrate objectively a direct causal relationship between a “good” board of directors and superior company performance, there is plenty of evidence to show

that a weak and ineffectual board will sooner or later allow even a good company to falter, lose its way, and perhaps even fail. Usually this happens when the board has somehow failed in its first duty of closely monitoring the CEO's performance and, when necessary, replacing him before it is too late. Some sobering examples of such corporate crises arising from the board's in-attention or failure to act have recently been much in the news, on both sides of the Atlantic.

A strong and independent board of directors is therefore the bedrock on which effective corporate governance must be founded. By statute and by corporate by-laws, the boards of public companies are already vested with all the legal powers they need to fulfill this vital monitoring role. But what often seems to have been lacking is the will to use these powers. And this ultimately depends on the leadership provided by the chairman: any board will only be as effective as its chairman wants it to be or is capable of making it.

To maintain a proper balance of power between a strong chairman and his board, and a strong CEO, it is necessary that the two roles be separated and held by two individuals. This is at present the case in more than 70 percent of UK public companies – and increasing – but only in about 20 percent in US companies.

THE CHAIRMAN

The position and title of chairman in the UK used to carry great authority, respect, and real power. But sometime in the mid-1970s the importation into the UK of the essentially US concept and title of chief executive officer began to erode the chairman's traditional status and authority – a trend reinforced by the adoption by compliant chairmen of the wholly unnecessary prefix of "non-executive." This was further aggravated by the growing practice of chairmen "going multiple" (i.e. individuals holding four, five, or even more non-executive chairmanships).

These trends were naturally welcomed and encouraged by a lot of ambitious CEOs, and in some cases even made a condition of the job. But the result was to diminish greatly the authority of many UK chairmen to the point where the position in some companies became almost nominal, with no real power.

But this is now changing in the UK. As one result of some well-publicized corporate disasters – Brent Walker, Maxwell Communications, and Polly Peck, to name three of the more notorious recent cases – the dangers of a weak and ineffectual board have become too glaring to ignore. Even the board of the venerable Barclays Bank has recently insisted that its chairman recruit an

outsider to take on the separate role and duties of chief executive.

The Cadbury Report recommendations, reinforced by some recent scandals, will thus, in time, swell the pool of stronger and more independent chairmen, who will in turn shape their boards to become the effective bodies that the laws require and the shareholders have a right to expect.

THE CHIEF EXECUTIVE

There is not serious doubt on either side of the Atlantic that a strong and capable CEO is the real key to superior company performance. Nor is there anything in the Cadbury Report that seeks to diminish the role of the CEO: all it argues is that it is better not to combine it with the role and title of chairman. The main thrust of its proposals is to restore a more even balance between what might be called the legislative and the executive branches of corporate governance – something Americans well understand.

Too often, however, the legitimate monitoring role of the board is seen by some CEOs as unwanted interference in the management of the company, and even as an attempt to undermine or second-guess their authority. Unfortunately, this can create an atmosphere of suspicion and mistrust across the boardroom table which can obscure the very positive role that a good board can play in supporting and helping the CEO. A cooperative and constructive partnership between them, not confrontation, is what a chairman should encourage between his board and the CEO.

What seems to have happened in the US is that, by tradition and by natural inclination of capable and strong-willed CEOs, the very title has become invested with dangerously large powers. When the title of chairman is also subsumed with that of CEO, these powers can become virtually absolute. And we know what Lord Acton has to say about that. It has even been said that some US CEOs now regard their boards as just another department within the corporate structure that needs to be “managed.” To the extent that this is so in any company, whether in the UK or in the US, shareholders have good reason to be concerned.

A HEALTHIER BALANCE

The essence of the Cadbury Commission proposals is to restore a healthier balance between quite different roles of an effective board of directors under the leadership of an independent chairman and the company’s management under the leadership of a capable CEO. Such a balance is difficult, if not impossible, to

sustain if the chairmanship and executive leadership are combined in one person. There are, of course, other good reasons for separating the two roles – for example, in a large and complex multinational group, the sheer magnitude of the combined tasks involved – but the “balance of power” argument is in my view by far the most compelling.

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