GLASS LEWIS

Independent Chair

In-Depth Report

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Background & Research

Glass Lewis' view is that shareholders are better served when the board is led by an independent chair, a role which we believe is better able to oversee the executives of the company and set a pro-shareholder agenda without the management conflicts that exist when a CEO or other executive also serves as chair. This, in turn, leads to a more proactive and effective board of directors.

Research suggests that combining the positions of chair and CEO may hinder a board's ability to dismiss an ineffective CEO. One study found that "the sensitivity of CEO turnover to firm performance is significantly lower when the CEO and chair responsibilities are vested in the same individual." It is the board's responsibility to select a chief executive who can best serve the company and its shareholders and to replace this person when his or her duties have not been appropriately fulfilled. We believe replacing a CEO becomes more difficult and happens less frequently than it should when the chief executive is also in the position of overseeing the board. Further, a 2009 study regarding corporate governance practices at U.S. corporations found that companies with combined chairs and CEOs tend to follow fewer positive corporate governance practices such as having declassified boards and calling frequent board meetings.[1] Board independence has been accepted as a best practice worldwide. In a study conducted by Farient Advisors, 97% of countries surveyed accepted a separate chair/CEO as a best practice, 53% of which have statutory requirements mandating this separation.

Some empirical evidence suggests that firms with separated CEO and chair roles outperform companies in which a single individual serves in both capacities. In addition, a more recent study by the Millstein Center for Corporate Governance and Performance at the Yale School of Management stated that "[t]he independent chair curbs conflicts of interest, promotes oversight of risk, manages the relationship between the board and CEO, serves as a conduit for regular communication with shareowners, and is a logical next step in the development of an independent board." Beyond the potential performance-related improvements of an independent chair, the cost of compensation is significantly lower. A 2012 study shows that CEOs who are not chairs earn 44% less than those that serve combined roles. Additionally, it is 25% less expensive to compensate a CEO and independent chair than a combined position. The same study also found that companies with separate roles have higher shareholder returns over extended periods of time.

On the other hand, some studies indicate that separating the roles of chair and CEO may have negligible or negative impacts on corporate performance. For example, some critics claim that separating the two roles leads to confusion and power struggles between management and the board.[2] Other studies suggest that the value of having a non-executive chair is largely dependent on the unique circumstances of a given company. While there might be various reasons for a company to separate the positions of chair and CEO, evidence shows companies that do so because of investor pressure and not for internal or structural reasons experience a decrease in market valuation and lower future operating performance.[3] A study of 152 Swiss companies found no evidence of a "systematic and significant difference in valuation" between companies with combined CEO and chair functions and those which have separated the two roles. Ultimately, most academics acknowledge that much of the literature on the separation of CEO and chair has produced inconsistent and conflicting results.

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[1] Joann S. Lublin. "Chairman-CEO Split Gains Allies." *Wall Street Journal*. March 30, 2009.
[2] Jay W. Lorsch, Andy Zelleke. "Should the CEO Be the Chairman?" *MIT Sloan Management Review*. January 15, 2005.
[3] David Larcker, Brian Tayan. "Chairman and CEO: The Controversy over Board Leadership Structure." Corporate Governance Research Initiative. June 24, 2016.

In one study, researchers set out to determine whether the CEO/chair structure impacts company valuation. For companies that consistently had either a combined CEO/chair or separated roles, there was no statistically significant difference in financial performance over 15 years, 3 years, or 17 months. Researchers concluded that separating the CEO and chair roles is not correlated with better financial performance. Further, they state that "there does not appear to be any compelling economic reason for public companies to adopt any particular CEO/chairman structure." Researchers recommend that companies focus on tailoring their leadership structure in a manner that best suits the company and its circumstances.

A 2014 article analyzing voting results for shareholder proposals seeking to split the roles highlights a similar difference of opinion among shareholders on this issue. The findings showed that, of approximately 200 shareholder proposals placed on ballots in 2013 and 2014, only four proposals received majority shareholder approval and none resulted in the actual separation of the roles of chair and CEO. Thus, it is argued that, absent key indicators such as poor performance, poor governance factors, and an "imperial" CEO or long-tenured directors, shareholders are reluctant to favor separating the roles. The article further states that the reluctance is not without merit, because the decision to separate these roles can significantly impact the future performance of a company; research has suggested that poor performing firms that separate the roles may experience enhanced performance, but for high performing companies, separation of the roles could have a negative impact on shareholder returns. Ultimately, however, the article concludes that any changes to a company's leadership structure will more likely be a result of indirect pressure rather than direct pressure from shareholder proposals and voting.[4]

Further, there appears to be a growing trend toward separation of the roles of chair and CEO. According to the 2020 Spencer Stuart Board Index, 55% of S&P 500 boards have split the chair and CEO roles, up from 53% in 2019 and 40% in 2010. However, Spencer Stuart notes that only 34% of S&P 500 boards have a truly independent chair, unchanged from last year and up from 19% in 2010. Of the 102 boards where the chair is separate but not independent, 5% have a lead or presiding independent director. Overall, 73% of S&P 500 boards have an independent lead or presiding director compared with 75% last year and 92% a decade ago. In the 2016 Spencer Stuart Board Index, among boards that expected to or had recently separated the chair and CEO roles, 72% of respondents cited a CEO transition as the reason behind the split, while 20% said that splitting roles of chair and CEO represents a best governance practice.

Controversies Prompting Change

In several cases, controversies have led to calls for companies to separate the CEO and chair positions. For example, in 2016, Wells Fargo amended its bylaws to require that the bank separate the chair and chief executive roles after a scandal over unauthorized customer accounts. The amendment also called for the chair and vice chair of the board to be independent directors.[5]

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[4] Robin Ferracone. "Combined Chairman/CEO Roles: Easier Than You Think." *Forbes*. March 5, 2014.
[5] Ross Kerber, Dan Freed. "Wells Fargo Amends Bylaws to Separate Chairman and CEO Roles." *Reuters.* December 1, 2016.

Further, in November 2018, Tesla appointed Robyn Denholm as board chair in response to the SEC demand that chair/CEO Elon Musk step down from the position. The appointment was required as part of a deal that Tesla and SEC regulators reached to settle fraud charges against the company.[6] In addition, in the wake of the 737 MAX scandal, Boeing's former CEO stepped down as chair of the company's board in October 2019 and was replaced by an independent director as a result of the fatal crashes. Boeing formalized the independent chair role in June 2020 following majority shareholder support for a related shareholder proposal.[7] Further, amidst pressure from activist hedge fund Elliott Management, AT&T announced that it would separate the roles of chair and CEO when its current chair and CEO retires in 2020.[8]

Facebook's CEO and chair Mark Zuckerberg has also faced increased pressure to step down as the company's chair. In October 2018, the New York City Comptroller, state treasurers of Illinois, Rhode Island, and Pennsylvania, and Trillium Asset Management announced their support for a shareholder proposal to name an independent board chair. The groups argued that the separation was necessary to help move the company past its recent controversies and reestablish trust after Facebook was involved in several data and privacy controversies in 2018, including its role in allowing users' data to be used by political analysis firm Cambridge Analytica.[9] Shareholders, again, proposed resolutions seeking the appointment of an independent during the 2019 and 2020 proxy seasons, which each failed to receive requisite support. Given Zuckerberg's control over the majority of votes at the company, it remains unlikely that such a resolution will pass in the foreseeable future.[10]

Final Thoughts

While much of the empirical evidence regarding the separation of the roles of chair and CEO remains contradictory and inconclusive, Glass Lewis nevertheless generally favors the installation of an independent chair in order to ensure independent board leadership on behalf of shareholders. We believe that the presence of an independent chair fosters the creation of a thoughtful and dynamic board not dominated by the views of senior management. Further, we believe that the separation of these two key roles eliminates the conflict of interest that inevitably occurs when a CEO is responsible for self-oversight.

[6] Pushkala Aripaka, Michelle Price. "Tesla Names Director Denholm To Replace Musk As Board Chair." *Reuters*. November 8, 2018.
[7] Julie Johnsson. "Boeing Quietly Split CEO, Chairman Roles After Investor Vote." *Bloomberg.* November 30, 2020.
[8] Edmund Lee. "AT&T C.E.O. to Stay Another Year After Challenge from Activist Fund." *New York Times*. October 29, 2019.
[9] Salvador Rodriguez. "Facebook Investors Sound off About Zuckerberg After Stock Plunges 40 Percent in Four Months." *CNBC*. November 26, 2018.
[10] Danielle Abril. "Angry Facebook Shareholders Fail to Dislodge Mark Zuckerberg as Chairman." *Fortune*. May 30, 2019.

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