



Hot Topics

Who's at the Helm of Your Company's Ship?

Board leadership structure continues to be top of mind for directors, investors, and members of management, especially given recent regulations in this area. Proponents of a split CEO/chairman structure assert that this model is the most beneficial for companies and best positions them for strong performance. Opponents of this structure emphasize that there is no irrefutable data demonstrating that companies that split the roles fare better than companies that combine them and further, that the combination of the roles helps to eliminate the potential for confusion and duplication of efforts. In analyzing this issue, it is important for companies to consider the background of the debate, review historical trends, and prepare for the future.

Background

SEC disclosure rules related to board leadership structure were finalized in December 2009 and took effect on February 28, 2010. These enhanced rules address disclosures on several aspects of corporate governance, including the following related to board leadership structures:

Under the amendments, a company is required to disclose whether and why it has chosen to combine or separate the principal executive officer and board chairman positions, and the reasons why the company believes that this board leadership structure is the most appropriate structure for the company at the time of the filing. In addition, in some companies the role of principal executive officer and board chairman are combined, and a lead independent director is designated to chair meetings of the independent directors. In these circumstances, the amendments will require disclosure of whether and why the company has a lead independent director, as well as the specific role the lead independent director plays in the leadership of the company. As we previously stated in the Proposing Release, these amendments are intended to provide investors with more transparency about the company's corporate governance, but are not intended to influence a company's decision regarding its board leadership structure.¹

In addition, the Dodd-Frank Wall Street Reform and Consumer Protection Act requires the SEC to further enhance the rules related to board leadership structure disclosure by mid-January 2011. The Dodd-Frank Act provision appears similar to the SEC rules that took effect for the 2010 proxy season.

Trends in Board Leadership

In looking to the future, it is helpful to examine the trends of recent years. The information presented below is based on an analysis of proxy statement disclosures of S&P 500 companies, as performed by Spencer Stuart and featured in *US Board Index* (series 2003–2010).²

| Year | Combine CEO/Chairman (as % of S&P 500) | Split CEO/Chairman (as % of S&P 500) | Independent, Non-executive Chairman (as % of S&P 500) |
|------|---|---|---|
| 2003 | 77% | 23% | Not Available |
| 2004 | 73% | 27% | 9% |
| 2005 | 71% | 29% | 9% |
| 2006 | 68% | 32% | 10% |
| 2007 | 65% | 35% | 13% |
| 2008 | 61% | 39% | 16% |
| 2009 | 63% | 37% | 16% |
| 2010 | 60% | 40% | 19% |

These statistics demonstrate that the number of S&P 500 companies separating the CEO and chairman roles has risen significantly since 2003. The percentage of companies with an independent non-executive chairman has also increased, from 9 percent in 2004 to 19 percent in 2010.² The independent chairman designation applies to a chairman that has no preexisting relationship with the company, such as being a former CEO or other executive team member.

Deloitte analyzed the proxy disclosures related to board leadership structure for the 77 S&P 100 companies that filed proxy statements after the disclosure rules were enacted on February 28, 2010, but before July 1, 2010. For both the combined and separated board leadership structure models, it appeared that companies utilized the arguments that have been frequently heard in the dialogue on this topic. Many of these are outlined in [Chairing the Board: The Case for Independent Leadership in Corporate North America](#), a working paper of the Chairmen's Forum, which was published in 2008 by Yale School of Management's Millstein Center for Corporate Governance and Performance.

Many of the rationales provided in the proxy statement disclosures of companies that split the roles of CEO and chairman were consistent with the generally accepted benefits of such a structure. These companies also often included a description of the non-executive chairman position. Among the reasons noted in the disclosures for splitting the roles:

- Potential conflicts of interest are eliminated.
- A separated structure recognizes the inherent differences between the roles, positioning the chairman to provide the CEO with guidance, advice, and counsel regarding business, operations, and strategy, and allowing the CEO to focus on managing the company's complex daily operations
- Robust director, board, and CEO evaluation processes are facilitated.
- Communication between the board and the CEO is enhanced.
- Such an approach can assist the board in reaching consensus on particular strategies and policies.
- The board's advisory and oversight roles are focused on assisting the CEO and senior management in seeking and adopting successful business strategies and risk management policies.
- Separating the board chairman and management roles can help in making successful choices for management succession.

For companies with a combined CEO and chairman role, the disclosures primarily focused on the duties of the lead or presiding director, and were largely consistent with the recommendations of Institutional Shareholder Services (ISS), which are described in more detail in the next section. These duties appear to have been significantly enhanced from descriptions of the role a decade ago. The rationales for a combined CEO/chairman structure provided in the disclosures included the following:

- The lead director position counterbalances the combined CEO/chairman structure.
- The board can act efficiently and effectively when the CEO/chairman serves with a strong independent lead director.
- The structure eliminates the potential for confusion and duplication of efforts.
- Other companies in similar businesses and industries have the same leadership structure.
- The combined role best positions the CEO/chairman to be aware of major issues facing the company on a day-to-day and long-term basis, and to identify key risks and developments facing the company that should be brought to the board's attention, in consultation with the lead director, as part of the agenda-setting process.
- The value of the individual in the combined position can be leveraged, including long-standing experience in the business and industry, relationships with stakeholders, or even being a company founder.

In its review of S&P 500 companies, Spencer Stuart identified only six companies with a formal policy stipulating that the roles of CEO and chairman would be separate at all times.² As the data shows, there is no one-size-fits-all approach to board leadership structure, and there does not appear to be consensus regarding which practice is best.

Looking Ahead

Because the SEC's disclosure rules regarding board leadership were passed near the end of 2009, companies may not have had sufficient time to consider changing their disclosure practices, or potentially their leadership structures themselves, before having to comply with the rules for the 2010 proxy season. Therefore, it would not be surprising to see additional enhancements and details in the 2011 disclosures. Further, the disclosures may reflect changes in actual board leadership practices.

Currently, based on a review of the applicable statistics, although the gap is closing, it appears that for most companies, maintaining a combined chairman and CEO structure, coupled with the appointment of a lead or presiding director, is a recognized model, and companies may default to this structure. The lead director can provide an external, independent voice on issues in which the combined chairman/CEO may have a personal stake. SEC rules require detailed disclosure regarding the role of the lead director. ISS, a proxy advisory firm, has recommended the following as effective lead or presiding director duties:

- Presides at all meetings of the board at which the chairman is not present, including executive sessions of the independent directors
- Serves as liaison between the chairman and the independent directors
- Approves information sent to the board
- Approves meeting agendas for the board
- Approves meeting schedules to assure that there is sufficient time for discussion of all agenda items
- Has the authority to call meetings of the independent directors
- If requested by major shareholders, ensures that he is available for consultation and direct communication³

Of further consideration are the ISS's recommendations regarding board leadership structure. ISS's 2011 voting policies are now final, and its prior-year policy in this area was not modified. ISS will continue to evaluate a company's leadership structure on a case-by-case basis, taking into account whether it has a robust counterbalancing governance structure involving an independent lead or presiding director, with clearly delineated duties, and whether there are any problematic performance, governance, or management duties. It will be important for companies to bear in mind ISS's recommendations, as well as those of other proxy advisory firms, as the 2011 proxy season approaches and companies disclose their board leadership structures.

Concluding Thoughts

Issues related to board leadership structure are being discussed increasingly in boardrooms, including as part of the succession planning process. With a heightened focus on shareholder proposals in this area and with CEO turnover increasing, discussion and debate will likely continue.

Although historically, a majority of S&P 500 companies have combined the roles of CEO and chairman, there is clearly an increasing trend toward greater independence for the role of chairman. Though there are many individuals and thought leadership organizations on both sides of the issue, most agree that the particular leadership structure selected by a company is largely dependent on the individual company and its circumstances; no one structure may best serve all companies in all situations and circumstances.

¹ Obtained from the U.S. Securities and Exchange Commission (<http://www.sec.gov/rules/final/2009/33-9089.pdf>)

² Obtained from Spencer Stuart *US Board Index* (series 2003 – 2010)

³ Obtained from Institutional Shareholder Services (ISS)

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