Separation in the roles of chairman and chief executive officer

MCCG Intended Outcome 1.0

Every company is headed by a board, which assumes responsibility for the company's leadership and is collectively responsible for meeting the objectives and goals of the company.

MCCG Practice 1.3
The positions of Chairman and CEO are held by different individuals.

The internalisation and application of the content "Why" and "How" should be read in tandem with the line of sight outlined by the Intended Outcome.

Why — The case for change

The chairman and the CEO are two key levers of a company. The chairman is responsible for **marshalling the effective functioning of the board** including the collective oversight of management. The CEO meanwhile spearheads the **business and day-to-day management of the company**.

Given the different nature of responsibilities that rests with the chairman and CEO, having these positions combined could potentially diminish the board's role in exercising objective oversight over management. Conflicts could be particularly prevalent in the areas of performance evaluation, executive remuneration, succession planning and the appointment of new directors. A representative of the California Public Employees' Retirement System ("CalPERS") once argued at the ExxonMobil's Annual General Meeting ("AGM") in United States that having a dual chairman and CEO is "**like grading your own exam papers**"[1].

The combination of these roles may also lead to an **excessive concentration of power** that is vested in one individual. At its worst, this could result in the infamous corporate governance issue of "imperial CEOs".

What could go wrong:

- The oversight role of the board over management is diminished.
- Deliberations in the boardroom are controlled by one individual.
- The director who assumes the position of chairman and CEO is accorded with unchecked powers, giving rise to potential abuse.
- Time commitment of the combined CEO and chairman is impaired which hinders the effective discharge of duties for both positions.

[1] Larcker, DF and Tayan, B 2016, *Chairman and CEO: The Controversy over Board Leadership Structure*, Stanford University

Point for reflection

An imperial CEO refers to a single autocratic individual who wields significant power by assuming the role of the Chairman as well as CEO of the company.

Imperial CEOs have unfettered control of the board and, intentionally or not, discourage discourse in the boardroom. More often than not, these individuals implement a range of policies that are tilted towards management's interests as opposed to the shared needs of management and shareholders. Their unchecked powers are further cemented by their unwillingness to relinquish the authority they have achieved and the board's reluctance to limit their powers as these individuals are viewed as integral to the company[2].

Given the ever increasing workload of board members in light of changing market dynamics and rising stakeholders' expectations, coupling the position of a chairman and CEO could also raise serious concerns on the time commitment of said director. The greater time commitment expected of directors is well encapsulated in a study by McKinsey which revealed that high-performing boards typically spend at least 40 days for boardroom activities[3].

Premised on the need to promote accountability and facilitate division of responsibilities between the chairman and CEO, enumerations such as the aforementioned **Practice 1.3 of MCCG** and **Standard 11.3 of Bank Negara Malaysia's Policy Document on Corporate Governance**[4] call for separation between the chairman and CEO.

How — The practice in substance

It is therefore important for the company to ensure that the positions of chairman and CEO are held by different individuals with a view of averting instances whereby one individual can dominate the board's discussions and decision-making.

The division in the roles of the chairman and CEO should be clearly defined in the board charter.

Key considerations relating to the application of this Practice are outlined below:

What are the factors that should be considered when demarcating the roles of the chairman and CEO?

Unless the roles are clear, the relationship between the CEO and the board including the chairman, risks devolving into misunderstandings, loss of trust, and ineffectiveness. To this end, it is important for the board to clearly define the respective functions and set out the boundaries of the chairman and the CEO.

Investors' perspectives

Companies with a combined chairman and CEO have often been subject to shareholders' scrutiny.

In addition, shareholders, particularly large institutional investors, are increasingly casting attention on companies with governance models that allow individual directors to be dominant or have unfettered powers.

For example, in 2014, a group of large shareholders in Oracle Incorporated, including California State Teachers' Retirement System wrote a letter to the other shareholders citing concerns about the board's accountability in the company. In the case of Oracle Incorporated, the CEO has stepped down (in title) to become an Executive Chairman of the Board and the Chief Technology Officer. In his place, the board appointed two CEOs from the executive suite to serve co-extensively - an unsustainable model that further consolidates the former CEO's control.

These institutional investors classified the company's leadership changes "as simply a rearrangement of the deck chairs which serves to further empower executive management".

[2] Scott, G 2004, *Unfinished Business: Abolish the Imperial CEO*, Journal of Corporate Accounting and Finance
[3] Bhagat, C & Kehoe, C 2014, *High performing boards: What's on their agenda?*, McKinsey
[4] The chairman of the board must not be an executive, and must not have served as a CEO of the financial institution in the past five years.

Pertinent considerations in carrying out the demarcation are outlined below:

- articulate the expected time commitment in the service contracts of the chairman and CEO;
- define the criteria for evaluating the chairman and CEO, taking into account the responsibilities outlined in the board charter and job descriptions;
- provide the CEO with the room to perform, but be prepared to intervene when the need arises; and
- clarify the nature and extent of the other directorships that can be held by the chairman and CEO.

What are the safeguards that should be put in place to foster greater objectivity in the boardroom when the company has an executive chairman?

An inherent safeguard is built from the application to **Practice 4.1 of MCCG** which stipulates that "at least half of the board comprises independent directors. For Large Companies, the board comprises a majority independent directors". This allows for more effective oversight of management as well as to support objective and independent deliberation, review and decision-making.

In addition, companies may consider **appointing a deputy independent chairman and/or a senior independent director** to serve as a sounding board to the chairman and in leading the performance evaluation of the chairman. The appointment of a **deputy independent chairman and/or** senior independent director would particularly go a long way in fostering objectivity in instances whereby the chairman and the CEO are related.

What are some of the symptoms which may indicate that power is concentrated in one individual director?

The board should be watchful of some of the following indicators which may indicate concentration of power in one individual director.

Echo chambers	Disparity in remuneration	Risk taking
The boardroom is reduced to an "echo chamber" whereby deliberations are centred around echoing the sentiments of an individual director. Succinctly put, there is a tendency for the views of the said individual to be deferred to and agreed with.	An individual director is being rewarded with a grossly excessive remuneration package and the "pay gap" vis-à-vis other directors and management personnel is hugely significant, after normalising factors such as responsibilities, credentials and performance.	An individual director who has the propensity to engage in or push for imprudent risk taking due to vested interests.

Dos

- ✓ Clearly delineating the roles and responsibilities of the chairman and CEO in the company's board charter.
- ✓ Articulating the time commitment that is expected of the chairman and CEO.
- ✓ Promoting a culture of openness and constructive challenge that allows for a diversity of views to be considered by the board.

Don'ts

The following would render the application of this practice ineffective:

- × Not putting in place clear procedures for clarity on the roles and responsibilities of the chairman and CEO as well as how conflicts in this regard can be dealt with.

Where — Regional/international perspectives

Alongside Malaysia, selected jurisdictions across the globe have emphasised the need to separate the positions of the chairman and CEO in order to promote accountability amongst board and management.

Country	Provision
United Kingdom	The roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board ***(Provision A.2.1)***. The chairman should on appointment meet the independence criteria set out in B.1.1[5]. A chief executive should not go on to be the chairman of the same company. If exceptionally a board decides that a chief executive should become a chairman, the board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next annual report ***(Provision A.3.1)***.
Australia	The chair of the board of a listed entity should be an independent director, and in particular, should not be the same person as the CEO of the entity. ***(Recommendation 2.5)***.

[5] Provision B.1.1 of United Kingdom's Corporate Governance Code relates to the determination of a director's independence.