CEO DUALITY – AN EXPLORATIVE STUDY

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Abstract

Corporate governance focus on a major issue to analyse whether the Chief Executive Officer of a firm should serve as board chairman is a debatable argument put forward in the changing world. In the wake of economic chaos globally with high-profile collapses of a number of large corporations in the recent years, has forced organisations to alter the composition of their corporate governance. The increase of pressure on corporate boards from enforcement agencies, as well as shareholders, challenges organisations to adopt new strategies and relook into their organisational structure. This article will look at literatures on various arguments put forward on the pros and cons of the CEO duality and its impact on firm effectiveness and performance. An analysis of theories of CG which includes Agency and Stewardship theories will be look into to have a clear picture on whether duality leads to firm effective performances or hinder performance. From the analysis, it can be concluded that there is no right or wrong board structure but generally shareholders and stakeholders are more inclined towards separation of the roles to promote independence and transparency. Although duality or separation may not have any direct linkage to firm performance, separation model promotes a healthier balance to the overall corporate governance of an organisation. A further research will be carried to look at the composition of the board in emerging corporations in gulf countries.

Keywords: CEO duality, Agency theory, Stewardship theory, firm performance

Introduction

Corporate governance normally refers to the guidelines by which corporations are managed. It specifies the distribution of rights and responsibilities among different participants in the corporation (such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) as well as the rules and procedures for making decisions in corporate affairs (Kiel & Nicholson 2003). Corporate governance mechanisms can be seen as falling into two main categories, either internal or external. Internal governance tools include the board of directors, subcommittees of the board, compensation programs designed to align the interests of managers and shareholders and other corporate control systems. External governance mechanism include accounting rules and regulatory reporting requirements, external auditors, the investment community, financial analysts, national laws and the shareholders themselves (Millet-Reyes & Zhao 2010). Duality role in a company means a person who has a dual role as Chairman of the board (COB) and Chief Executive Officer (CEO) at the same time. Many companies in this era implement the policies that provide the opportunity for the COB to also take part in a company as CEO. Duality role in a company rises to some debate / disagreement about the negative effects of the duality role in a company. There are two theories that support and reject the duality role in a company which is agency theory and stewardship theory. Agency theory which denies the duality role can be defined as " the relationship between the principals, such as shareholders and agents such as the company executives and managers" Jensen & Meckling (1976), while the Stewardship theory that supports the duality role can be defined as a " a steward Protects and maximises shareholder wealth through firm performance, Because by so doing, the steward's utility functions are maximized " Donaldson (1990).

One of the key topics in corporate governance is the link between CEO duality and firm performance. CEO duality here refers to a firm’s Chief Executive Officer that also serves as Chairman of the board of directors (Boyd 1995). Various surveys carried out between 1999 and 2005 shows that in the United States of America (USA) between 60 and 80 per cent of all major corporations have the same person act as both the CEO and Chairman, whereas British, Canadian and Japanese companies has only about 10 to 20 per cent of the combined role (Brownbill 2010). Some researches cannot substantiate conclusively a linkage between CEO duality and firm performance (Anderson, Melanson & Maly 2007) whereas others have recommended that the separation of the roles would provide a healthier balance to the relationship (Parker 1994). The purpose of this exploratory study is set out to investigate the relationship between firm performance and CEO duality. So the key question is whether CEO duality can be classified as a more superior method of successful corporate governance and in turn contributes to effective firm performance?

In this article, there are some sections such as literature review and critical analysis that will be used. The literature review section will discuss the descriptions of duality role, debate on agency theory and stewardship theory, application of agency theory and stewardship theory. Whereas in the critical analysis will look into the relationship between the duality role with organization performance (ROA) and financial performance (ROE). In addition, the advantages and disadvantages of duality role will also be discussed in this article to assist in deciding which one is better.

Methodology

The methods that will be used to assist in the completion of this article is by using secondary data from previous research that has been done by other researchers and combined with my own critical analysis to give a conclusion whether a company should implement duality of role / duality role should be separated.

Literature Review

CEO duality is a situation in which the Chairman of the Board at a company who also a Chief Executive Officer at the same time. This dual role is a policy from a company that implements a position to fill as COB and CEO. CEO duality requires a person to be able to perform the role as COB and CEO at the same time to lead the company. The roles of the COB are different with the roles of the CEO, but in the CEO duality; the person is required to carry out these roles simultaneously. Several roles as a COB are to ensure effective operation of the Board, to support and advice the CEO in the development and implementing the strategy, and some other roles. On the other hand, the roles of the CEO are to develop strategies for recommendation to the Board and ensure that agreed strategies are reflected in the business, ensure that the business performance is consistent with the Business Principles, and several other roles.

CEO duality in a company raised some debate among some researchers who rejected the duality role through the agency theory and who supports the existence of duality role through a stewardship theory. Besides, the advantages / disadvantages of CEO duality also provide arguments in determining whether CEO duality role good / bad for a company. Some differences in the opinion of the researchers regarding the duality role is (Pfeffer and Salancik, 1978) who argue that “having leadership that is focused with a single individual increases a firm's responsiveness and ability to secure critical resources”. On the other hand “CEO duality diminishes the monitoring role of the board of directors over the executive manager, and this in turn may have a negative effect on corporate performance” (Dayton, 1984). This is certainly raises a very serious debate among the researchers in support their argument to determine which one is better for a company.

CEO Duality (Pros and cons)
Advantages of CEO Duality

Clear direction of a single leader: A BOD who also serves as CEO certainly has enormous power within a company. The advantage to be gained by the presence of CEO duality is a clear direction of a single leader, this happens because of all the activities undertaken by the company only rely on one person. This is of course will provide a clear direction from the CEO to their managers, stakeholders, and their subordinates regarding the strategy and business decisions that exist within the company.

Efficiency and Effectiveness: In the CEO duality, efficient means the company does not need to spend more money to hire CEOs from outside so that it will certainly provide efficiencies for the company in minimizing their expenses. On the other hand, effective in the presence of CEO duality means substantial power as the BOD and CEO provide the effectiveness of the company in making a decision to reach the goals of the company; this is because in CEO duality does not require a long process in making a decision, so it will save more time.

Disadvantages of CEO Duality:

Segregation of Duty: A strong power in the CEO duality actually is good because it can create a clear direction of a single leader, but on the other hand it is also a disadvantage of CEO duality. This is because if a person has enormous power within a company then it will create segregation of duty.

Lack of transparency: This happen because of the strong power possessed by the CEO duality provides an opportunity to hide whatever is in the company which resulting in lack of transparency of the company.

Theories of Corporate Governance:

Agency theory

It was first used as a theory in economics by Alchian and Demsetz (1972). In the past decades, the agency theory which can be explained as the relationship between the principal (Stakeholders) to its agent (Management) is more often used as theories in many fields. Eisenhardt (1989) states that "the agency theory is used in many fields such as accounting, marketing, organizational behaviour, political science, and sociology". Basically, agency theory is a theory which suggests the separating roles of the BOD and CEO in running a company to achieve the goals. Agency theory emphasizes that a company should not be led by one person who plays a dual role as the BOD and CEO in a company. This means that the principal elects the board, who in turn elect the management team to execute the routine daily business decisions (Abdullah and Valentine, 2009). The purpose of the agency theory which suggests that the separation of roles between the BOD and the CEO is to reduce agency cost. Other than that the theory also assumes that when a conflicting management decision, the principal or the agent has selects the best option that increases their own self - interest (Davis et al., 1997). Agency theory is the most dominant theoretical framework in corporate governance research. It is a simple theory that corporations consists of two participants – managers (agents) and shareholders (principal) and the fact that human beings act as self-interested and generally unwilling to sacrifice personal interests for the interest of others (Brownbill 2010). Agency theory suggests that CEO duality increases an organisation's agency cost as management might pursue their own self-interest by forgoing an opportunity that may be in the best interest of the shareholders. Hence it is believed that in order to minimise agency costs, the role of CEO and chairman should be split (Abels & Martelli 2011). Generally duality deteriorates the fiduciary oversight power of the board of directors – in other words, there wouldn't be a solid checks and balances mechanism (McGrath 2009). CEOs are held liable to shareholders through the Chairman and the board of directors. When a CEO dominates the board through a dual role, it can hamper and weaken the protection sought by shareholders (Nicholson & Kiel 2007). An implication of agency theory is that where CEO duality is retained, shareholders interest could be protected by aligning the interests of the CEO and shareholders by a suitable incentive scheme for the CEO (Donaldson & Davis 1991). CEO duality can also complicate the issue of CEO succession whereby the CEO retires but remain his/her role as the chairman. Although the role is separated but the chairman role is no longer deemed as independent and the board might take sides with the chairman whom they have a history with that would lead to conflict of interest (McGrath 2009).

Stewardship theory

This is an alternative framework to the agency theory, with its roots in psychology and sociology, and it explains corporate structures in which the stewards (management) are inclined and motivated to operate in the best interest of their shareholders (Davis et al., 1997). Stewardship theory is a theory which supports the CEO duality in a company and this theory is the rejection of the agency theory which explaining the negative effects of the duality role and suggests duality role should be separated. Stewardship theory emphasizes that a firm should apply the duality role where BOD is also the CEO of a company. The main purpose of the existence of stewardship theory is to reduce the monitoring and controlling costs; this is because if a BOD also becomes the CEO, the company certainly does not need to pay more to hire a CEO from outside the BOD. Other than that, (McGrath , 2009) stated that "the merging of duality roles institutes a harmony between the board of directors, managers and shareholders, the which is more efficient and effective in order to reach the goals of increasing sales and profit maximization within organizations". Stewardship theory deems that management (stewards) are inclined and motivated to operate in the best interest of their shareholders. Unlike agency theory, it believes that management are trustworthy stewards who ultimately desire to execute decisions that benefit the entire organisation rather than personal gratification (Abels & Martelli 2011). The supporters of this theory believe that when one person holds both roles, he or she is able to act more efficiently and effectively. Duality creates unity across the company's managers and board of directors, which ultimately allows the CEO to serve the shareholders better (McGrath 2009). Studies have shown that the returns to shareholders are improved by combining rather than separating the roles of the chairman and CEO which appeases the stewardship theory. It is said that when owner (principle) reduces its power but instead empower their managers then the returns of shareholders are safeguarded (Donaldson & Davis 1991).

It is believed that separation of the roles dilute the power of the CEO to provide effective leadership, creates potentiality of rivalry between the chairman and CEO, leading to compromise rather than decisiveness and having two spokesperson can lead to confusion and opportunity for third parties to take advantage of the situation. Joint roles may enhance external relationship as it is interpreted as an organisation with strong leadership and a clear sense of direction (Daily & Dalton 1997).

Debate of Agency Theory and Stewardship Theory

Debate between agency theory and stewardship theory by several researchers produce a lot of different views on each of these theories. Agency theory that supports the separation roles of the COB and CEO stated that CEO duality gives a negative effect for the company. Agency theory emphasizes the negative impact of CEO duality in terms of company performance (ROA) and financial performance (ROE) in a company that adopted a system of CEO duality.

This statement is supported by several researchers such as Jensen and Meckling , 1976; Fama and Jensen , 1983; Eisenhardt , 1989; Rechner and Dalton , 1991; who states that "a centralized authority leadership may lead to management 's domination of the board , the which results in poor performance". By seeing the negative effects caused by the CEO duality certainly make many people feel that CEO duality is a bad thing for a company.

Several researchers through their respective arguments debate about stewardship theory as a counter in response to agency theory which stated that CEO duality should be separated. Stewardship theory which supports the duality role in a company's emphasizes that CEO duality gives positive effect within a company. Stewardship theory emphasizes the flexibility that is owned by the COB who also the CEO can assist in improving company performance (ROA) and financial performance (ROE). This statement is supported by several researchers who support the existence of CEO duality such as Donaldson and Davis, 1991; Davis et al., 1997, who states that “corporate performance can be enhanced, when the executive manager has full authority over his corporation by serving also as the chairman, as less conflict is Likely to happen”. This is of course led to a long debate between the two theories that would cause confusion for many people.

So which theory is more favourable? A lot of studies are inconclusive and has a mix outcome on which framework is more superior to the other. Generally studies have shown that independent directors are associated with higher firm performance (Abels & Martelli 2011). Separation of the roles does indicate higher independence where a chairman is non-executive or not previously a CEO of the organisation but who has sufficient knowledge of the industry and commitment to the job alongside a dynamic boardroom culture would allow the chairman and the board to provide a fresh perspective when examining issues raised by management (Coombes & Wong 2004). The most visible support of separation of the roles is activist shareholders which are normally institutional investors. They are an increasing powerful force in the corporate world controlling more than one trillion dollars of corporate equity (Daily & Dalton 1997). The continuous assertion to the debate is that a chairman should be an independent monitoring/counsellor of a firm’s management especially to the CEO whereby separation of the roles do provide this independence (Daily & Dalton 1997).

Generally corporate governance in the United Kingdom and the United States shares a lot of similarities but when it comes to CEO dualism, there is a big difference in view. The view in the United Kingdom and other countries (refer to fig.1 below) that embrace the idea of separation is that the tasks of the chairman and CEO are different and potentially conflicting (Coombes & Wong 2004). One of the major roles of the chairman is to monitor and manage the CEO. It is also believed that when the roles are combined, it gives an opportunity for information to be withhold and therefore reducing transparency and access to information. Essentially the separation of the role is to provide a healthier balance and a check and balance mechanism to the system (Parker 1994). Some says that separation is viewed as an emergency measure for financially troubled companies (Daily & Dalton 1997). Generally the role of the board is to provide guidance to management who then look into the day to day function of the organisation.

The board's role is to actively question the CEO and seek for open information and open dialogue in order to have an effective decision making process (Kiel & Nicholson 2003). There is plenty of evidence to show that a weak and inefficient board will sooner or later allow even a good company to falter, lose its way, and perhaps even fail. A strong and independent board of directors is therefore the bedrock on which effective corporate governance must be founded (Parker 1994).

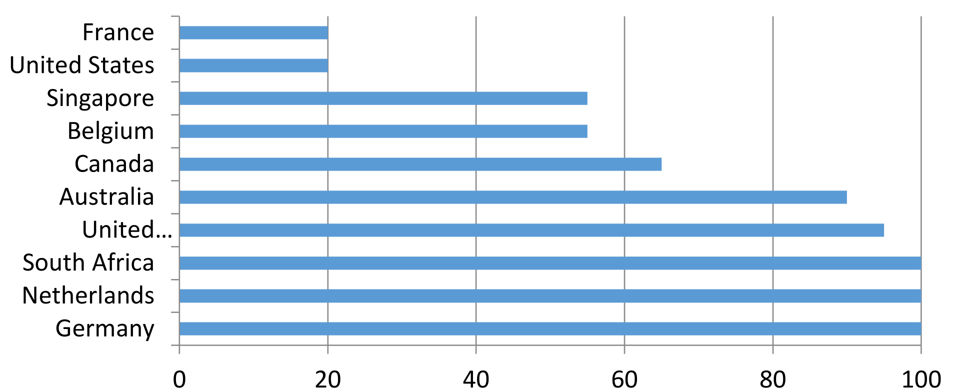
It is well known that there are two main types of board structure: one-tier boards (unitary) and two-tier boards (Tse 2009). Within Europe, the United Kingdom is a prominent country with a one-tier board system whereby Germany employs the dualism of a management board and a separate supervisory board (Jungmann 2006). In Australia and the United States, unitary boards structure are practised as well (Kiel & Nicholson 2003). Unitary board refers to a single layered board structure that consists of non-executives and executives directors. The other board structure, dualism board consists of a supervisory board and executive board of management where there is a clear separation of functions between supervision and management (Tse 2009). In the United Kingdom, although it follows a unitary board structure, about 95 per cent of all FTSE 350 companies adhere to the principle of separating the CEO-chairman role. In the United States, by contrast, about 80 per cent of S&P 500 companies practices CEO duality.

The chart below depicts the percentage of listed companies in ten countries globally with split chairman-CEO roles (Coombes & Wong 204):

Fig. 1

To split or not to split?

% of listed companies with split chairman-CEO roles



From the chart above it can be seen that separation of the role is gaining popularity in the 21st century. Majority of the countries listed in the chart have more than 50 per cent of its listed companies with split chairman-CEO roles.

So what is the relationship between CEO duality and firm performance? Studies seem to indicate that duality doesn't have a direct correlation to how well a company performs. It is surprising to learn that high-profile corporate scandals like Enron and WorldCom which is essentially due to CEO corruption, did not have a duality structure (Coombes & Wong 2004).

In an empirical study conducted in 2014 on European Union (EU) listed firms by Huining Chen (2014) revealed that CEO duality does not have much influence on firm performance. There still exist a debate ongoing with the primary theories of CG, agency and stewardship.

Recommendations and Conclusions

From the studies and researches, it seems that there is no right or wrong board structure or theory towards successful corporate governance and in turn firm performance. No other board structure is more superior to the other. It is highly dependable on the goals and strategy of the organisation, legal requirements of the country as well as underlying human factors. Supporters of separation generally believe that independence of the board is the key to successful corporate governance whereas dualism believes that it showcases unity and strong leadership. In every businesses there is a need for a check and balance mechanism which CEO duality seems to be lacking. Generally who is monitoring the CEO except the CEO in a duality model? CEO duality also does not promote independence in the corporate structure which is an essential element to healthy corporate governance. Separation on the other hand promotes independence but it is also largely dependable on the characteristics of the individual person handling the separate roles. It can also lead to conflicts when both parties are dominant.

The recommendation is that with the increasing demand and expectations from shareholders and stakeholders and the sheer magnitude of the combine tasks involved, it is not encouraging for one individual (CEO and chairman) to carry two such increasingly difficult jobs. Separation of the role provides a healthier balance especially in a large and complex multinational group. It would allow space for CEO to focus on the day-to-day management of the business whilst the chairman to look into the board's expanding responsibilities. Having said that, the essential part of the separation module is the CEO-chairman relationship in ensuring that there is transparency and a continuous flow of information between both parties for effective decision making in the interest of the shareholders and stakeholders.

CEO duality can be effective during certain period of time such as financial crisis or when the organisation is at its early stage as it would promote fast decision making and portray a united front to stakeholders. However, as the organisation grows and the structure becomes more complex, it does not promote independence, transparency and balance of power. There is no right or wrong board structure but generally shareholders and stake holders are more inclined towards separation of the roles to promote independence and transparency. Although duality or separation may not have any direct linkage to firm performance, separation model promotes a healthier balance to the overall corporate governance of an organisation.

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