Someone to watch over them

One hat is enough for (almost) any chief executive.

Illustration by Brett Ryder

Is there any limit to the audacity of Scandinavians? Not content with stirring up America's polarised politics by awarding Barack Obama a premature Nobel peace prize, they are also stirring up America's polarised debate on corporate governance.

This time the culprits are not the Norwegian politicians who award the peace prize, but the savvy investors who run Norges Bank Investment Management (NBIM), which manages a state pension fund of $400 billion. NBIM is trying to persuade four American companies—Harris Corporation, Parker Hannifin, Cardinal Health Incorporated and Clorox—to separate the jobs of chief executive and chairman of the board when they next appoint chief executives. The fund has already scored a notable success by persuading Sara Lee to split the two jobs. It says that this is only the beginning of its campaign.

America is unusual in the power that it awards to chief executives. Splitting the two jobs is commonplace in Canada, Australia and much of continental Europe (though France is a notable exception: even AXA, one of the few French firms to separate the roles, now wants to fuse them). In Britain 95% of companies in the FTSE 350 list have an outside chairman. But in America 53% of Standard & Poor's top 1,500 companies combine the two jobs.

The economic crisis has put the supporters of this bit of American exceptionalism on the defensive. Shareholder activists are up in arms about imperial bosses, and they scored a notable hit in April when they forced Ken Lewis to surrender his second hat as chairman of Bank of America, after his decision to buy Merrill Lynch (Mr Lewis has since lost his first hat as well). A growing number of bigwigs are agitating for change. Chuck Schumer, the senior senator for New York, has introduced a "Shareholder Bill of Rights" which, among other reforms, would force companies to separate the two jobs.

The case for separation is based on the simple principle of the separation of powers. How can boards discharge their basic duty—monitoring the boss—if the boss is chairing its meetings and setting its agenda? How can a board act as a safeguard against corruption or incompetence when the possible source of that corruption and incompetence is sitting at the head of the table?

Dual-purpose bosses make it more difficult for the board to manage the succession from one chief executive to another. ITV, a British broadcaster, is paying dearly for its decision to appoint Michael Grade as both chairman and chief executive: not only is it scrambling to fill two jobs at once but it also keeps losing leading candidates, bringing ridicule down on its head and forcing it to make do with a lame-duck boss. Two-timers also reinforce popular doubts about the legitimacy of the system as a whole, conjuring up images of bosses writing their own performance reviews and setting their own salaries. It is notable that one of the first things that some of America’s troubled banks, including Citigroup, Washington Mutual, Wachovia and Wells Fargo, did when the crisis hit was to separate the two jobs.

These arguments are so compelling that it is tempting to dismiss the opposition out of hand. That would be a mistake. The defenders of fusion point out that there is no solid evidence that splitting the two jobs does any good. Over the past two decades academics have produced more than 30 studies comparing the financial performance of companies that divide the two roles with those that combine them. The result is a wash: Enron and WorldCom both split the two jobs, as did the Royal Bank of Scotland and Northern Rock.

Separating the two jobs may produce all sorts of undesirable consequences. Chief executives may find it harder to make quick decisions. Ego-driven chief executives and chairmen may squabble over who is ultimately in charge. The shortage of first-class business talent may mean that bosses find themselves second-guessed by greybeards who know little about the business.

Anyway, traditionalists argue, America is already dealing with the problem of conflicts of interest in its own way. American boards are far more independent than they were as recently as five years ago. More than 90% of S&P 500 companies have appointed “lead” or “presiding” directors to act as a counterweight to a combined chairman and chief executive.

It is possible to pick holes in all these arguments. Many of them constitute a rejection of all robust systems of monitoring. “Presiding” directors sound like an unsatisfactory compromise—especially if they do not actually preside. Even at those firms where merging the jobs has worked reasonably well in the past, it may not do so in the future. Today’s global bosses have enough on their plates without having to chair board meetings as well. Boards are becoming more independent and professional, rendering the old-style strongmen ever more of an anachronism.

Just tell me why

But these objections nevertheless suggest some important caveats to the case for driving bosses out of the boardroom. There is no one-size-fits-all solution. Smaller companies, particularly start-ups, may benefit from the simplicity and clarity provided by bosses with two hats. Separating the two jobs is only one element of better corporate governance, as the many disasters presided over by independent chairmen demonstrate. Companies need to devote as much thought to the chemistry between the boss and chairman as they do to getting the structure right.

The best solution to the corporate problem is evolutionary, rather than revolutionary: pressure from activists and investors rather than sweeping legislation from Congress. Back in 1992 Sir Adrian Cadbury ushered in a boardroom revolution in Britain when he urged companies to comply with his recommendation to split the two jobs or explain why they had not. “Comply or explain” would not be a bad battle-cry for boardroom reformers the world over.

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