The Changing Role of the Chairman

Impact of Corporate Governance Reform in the UK on Role, Board Composition and Appointment

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Our Research

How has the role of chairmen and the functioning of boards changed over the last 10 years due to corporate governance reform?
Unique British System

The British Corporate Governance System is in many ways unique:

– comply-or-explain,
– split CEO/Chairman,
– chairman independent at time of appointment,
– extensive shareholder rights.
Methodology

- In-depth structured interviews with 24 Chairmen of 25 FTSE 350 companies.
Caution

There is no conclusive evidence linking board structure – or the separation of the CEO and Chairman positions – to firm performance.
Conclusions from Interviews
Chairman / CEO Split

Strong, but not unanimous support for role split:

- Task of running the board and running the company are becoming more different from each other (and more complex).
- Unlikely that one person has both sets of skills.
- 3.9% of FTSE 350 companies held a joint CEO/CM position in 2004.
The Chairman / CEO Relationship

Effectiveness of board depends on how well the two work together:

– complementarity in skills, experience and personality,
– clear (written) job descriptions,
– paternal rather than fraternal.
The role of the (Non-) Executive Chairman

- Chairman not detached monitor, but active and fully committed to success of firm.
- Practical degree of involvement very dispersed, ranging from 4 days/week to 1 day/fortnight (average 2.3 days).
- Separation Exec/Non-exec. Chairmen not helpful, as in the end the “buck stops with the Chairman”.
- In 2005, 79% of Chairmen of FTSE 350 firms self-declared themselves as non-executives, vs. 47% in 1995.
Appointing a new Chairman

Qualities that are sought after:

• Experience of bottom line accountability.
• Track record of making good appointments.
• Understanding of the business.
• Complementarity with Chief Executive.
• Appointment out of the ranks of existing outside directors.
Appointing a new Chairman: Role of Investor

- Investors focused on role separation CEO / Chairman.
- Normally no attempt to influence individual choice.
- However, we witness an increasing number of cases where they do.
When can the CEO become Chairman?

• General, but not unanimous, support to appoint outside Chairman (4 interviewees moved from CEO to CM).

*For:* Availability of detailed knowledge of the firm or sector can be of importance in highly regulated or complex, high technology sectors.

*Against:* Difficult for ex-CEO to establish good working relationship; danger of either standing back too far or to interfere too much.
Two American Views

• James Brickley et al. (1997):  
  – where US companies separate the roles, the Chairmen are almost always people with detailed knowledge of the company and high stock ownership.
  – find no evidence that unitary leadership structure is associated with inferior accounting and market returns.

• Ira Millstein and Paul MacAvoy (2003):  
  – Appointment of an independent chairman, separate from the CEO, is critical to positioning the board as an objective body and to the board’s ability to obtain the information that is needed and prevent management from obfuscating important issues.

Some empirical facts based on a sample of FTSE 350 firms from 1995, 2000 and 2005
Chairmen - Number of years on board

- 2000:
  - > 20 years: 66%
  - < 20 years: 20%
  - < 10 years: 14%

- 2005:
  - > 20 years: 72%
  - < 20 years: 19%
  - < 10 years: 9%
## Chairmen - Number of years on board

<table>
<thead>
<tr>
<th>Year</th>
<th>Non-Financial Firms</th>
<th>Financial Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Average</td>
<td>Median</td>
</tr>
<tr>
<td>2000</td>
<td>10.4</td>
<td>6.0</td>
</tr>
<tr>
<td>2005</td>
<td>9.4</td>
<td>6.7</td>
</tr>
</tbody>
</table>
Chairmen - additional board seats

<table>
<thead>
<tr>
<th></th>
<th>Average</th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>3.0</td>
<td>258</td>
</tr>
</tbody>
</table>

Bar chart showing the percentage distribution of additional board seats in 2000.
# Chairmen - Number of board seats

<table>
<thead>
<tr>
<th>Year</th>
<th>Mean</th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>3.0</td>
<td>258</td>
</tr>
<tr>
<td>2005</td>
<td>1.7</td>
<td>308</td>
</tr>
</tbody>
</table>

![Bar chart showing the distribution of chairmen roles across years](chart.png)
Chairmen – not getting younger

![Bar chart showing age distribution of chairmen in 1995]

- <=40: 2%
- 41-45: 2%
- 46-50: 9%
- 51-55: 14%
- 56-60: 35%
- 61-65: 29%
- 66-70: 7%
- 71-75: 2%
- 76-80: 1%
- >80: 0%
Chairmen – not getting younger

Corporate Governance at LSE
Chairmen – not getting younger

⇒ This effect is driven by small and medium size companies
# Identities of Chairmen

(FTSE350 industrial companies, 2004)

<table>
<thead>
<tr>
<th>Title</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sir</td>
<td>15.3%</td>
</tr>
<tr>
<td>Lord</td>
<td>4.2%</td>
</tr>
<tr>
<td>Academic (Dr / Prof)</td>
<td>6.5%</td>
</tr>
<tr>
<td>The right Honourable</td>
<td>1.3%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Nationality</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>British</td>
<td>84.1%</td>
</tr>
<tr>
<td>French</td>
<td>1.3%</td>
</tr>
<tr>
<td>German</td>
<td>1.0%</td>
</tr>
<tr>
<td>American</td>
<td>2.3%</td>
</tr>
<tr>
<td>Unknown/Other</td>
<td>11.4%</td>
</tr>
</tbody>
</table>
The UK Board: The rise of NEDs

<table>
<thead>
<tr>
<th>Year</th>
<th>Board Size</th>
<th>Execs</th>
<th>NEDs</th>
<th>% NEDs</th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>9.69</td>
<td>5.20</td>
<td>4.50</td>
<td>46%</td>
<td>173</td>
</tr>
<tr>
<td>2000</td>
<td>9.83</td>
<td>4.77</td>
<td>5.06</td>
<td>51%</td>
<td>234</td>
</tr>
<tr>
<td>2005</td>
<td>9.73</td>
<td>3.92</td>
<td>5.81</td>
<td>59%</td>
<td>314</td>
</tr>
</tbody>
</table>
Overall conclusion

Corporate Governance reform has:
• improved the quality of the board,
• but also made the role of the Chairman more challenging.
Overall conclusion

The challenge for the Chairman is to:

• manage potentially awkward relationships with the CEO and other NEDs,
• select a balanced and well-functioning board,
• avoid the risk that governance issues crowd out other more strategic agenda items.