Director Notes

Separation of Chair and CEO Roles

Importance of Industry Knowledge, Leadership Skills, and Attention to Board Process

by Richard Leblanc and Katharina Pick

In light of required disclosure about board leadership structure, the decision of whether or not to separate the chairman and chief executive roles remains a hot governance topic for public companies, boards, and shareholders. This report examines some of the academic literature surrounding the debate and proposes that board effectiveness is affected by the chairman's industry knowledge, leadership skills, and influence on board process rather than by the particular leadership structure chosen.

Since the early 1980s, much attention has been paid to corporate boards of directors and how their structures improve (or undermine) organizational performance. Among the most hotly debated structural features of the board is the combination (or separation) of the chair and CEO roles. As of February 2010, Securities and Exchange Commission (SEC) rules require listed companies to disclose their board leadership structure and explain why they have determined that such a leadership structure is appropriate, given their specific characteristics or circumstances.[1]

A Recent Trend toward Separating the Roles of Board Chair and CEO

When, as after the recent financial crisis, public corporations come under fire from activist shareholders, institutional investors, proxy advisory firms, and regulators, the issue of separating the chair/CEOs roles is often front and center, with a view to achieving independent leadership on the board. Both academic papers and practitioner-oriented literature routinely call for separation of the chair and CEO roles, as do a variety of best practice codes and guidelines.[2]

1 Proxy Disclosure Enhancements," Securities and Exchange Commission Final Rule, adopted December 16, 2009, effective February 28, 2010.

2 For example, The UK Corporate Governance Code, June 2010 (at s. A.3.1); and King III Code of Governance Principles for South Africa 2009 (at 2.16).

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Some corporate leaders and associations, however, have responded to the debate about the pros and cons of role separation, often resisting a mandated separation or a "one size fits all" approach.[3]

In the most common argument based on agency theory, the separation of the chair and CEO roles increases the board's independence from management and thus leads to better monitoring and oversight. Because the CEO manages the company and the chair leads the board in overseeing (hiring, compensating, and replacing as necessary) the CEO on behalf of shareholders, holders of this view see a conflict of interest if one person occupies both the CEO and chair roles.

In contrast, stewardship or administrative theory suggests that the benefits of separating the chair and CEO roles are not so clear-cut. Stewardship theory is based on the principle of "unity of command" and argues that having clear and unambiguous authority concentrated in one person is essential to effective management. Unity of command creates clear lines of authority to which management (and the board) can respond more effectively. In an environment where strong, directive, stable, and unconfused leadership is seen as critical to organizational success, this kind of legitimacy is an important signal to stakeholders about who is accountable.

Unsettled Academic Literature

The academic literature for separation of the roles of chair and CEO is also not definitive. One study found "only weak evidence that duality status affects long-term performance, after controlling for other factors that might impact that performance."[4] Another concluded that there is "no statistical relationship between independence and firm performance … or relationships so small to be almost meaningless."[5] A third study concluded there was "no evidence of substantive, systemic relationships between corporate financial performance and board leadership structure."[6]

3 For example, the Association of Corporate Counsel; the Center for Capital Market Effectiveness; and the Society of Corporate Secretaries and Governance Professionals.

4 B. Ram Baliga, R. Charles Moyer & Ramesh S. Rao, "CEO Duality and Firm Performance: What's the Fuss?" *Strategic Management Journal,* 17, 1996, 41-53.

5 Lynne Bennington, "Review of the corporate and healthcare governance literature," *Journal of Management and Organization,* 16(2), 2010, 314.

6 Dan R. Dalton, Michael A. Hitt, S. Trevis Certo, and Catherine M. Dalton, "The fundamental agency problem and its mitigation: Independence, equity, and the market for corporate control," *The Academy of Management Annals*, 1: 1-64, 2007, p. 13.

Separate Chair Behavior

Some governance researchers also warn that formal structural separation of the board's leadership roles is not sufficient for board performance and may even undermine it. Andargachew Zelleke's comparative study of boards in the United Kingdom and the United States, which was based on interviews with more than 50 directors of major public companies and 18 chairs, reveals a number of problems with separating the roles.[7] His findings for U.K. boards show that a remarkably wide range of roles and activities fall under a separate chair's purview at different companies. In some cases, chairs were closely consulted on strategy and even took on some executive functions, while others assumed an almost exclusively monitoring role. In other words, there was not a clear and defined job description for the separate chair position. Although there are distinct benefits to the chair's separated role, including greater attention to the board's functioning and even a lightened load for the CEO, lines of responsibility are often blurred between the two roles. As a result, Zelleke found CEOs and chairs can often be distracted by (and have their independence compromised by) struggles over power and territory (and accountability when things go wrong).[8]

The actual *behavior* of the chair becomes extremely important, particularly in an environment such as the United Kingdom, where that position carries a great deal of status and typically is filled by very experienced former CEOs of other companies (not companies where they serve as chair). According to Zelleke's interviewees, for example, learning to bite one's tongue, or resisting the urge to "to use one's power at the board and … run a sort of campaign against the chief executive … to try and make him more like you," are important behaviors.[9] The formal definition of the role of chair and how it interfaces with the CEO's responsibilities (i.e., having separate, explicit position descriptions) is also important.

Separate Chairs Aren't Necessarily Independent

Board data also call into question whether separating the chair/CEO roles actually creates the independent leadership advocates of the practice think it does. Despite the larger numbers of separate chair positions in large American companies—37 percent of the S&P 500 in 2009 (184 companies),

7 Andargachew Zelleke, *Freedom and constraint: The design of governance and leadership structures in British and American firms.* Ph.D. dissertation, 2003, Harvard University.

8 Jay W. Lorsch and Andy Zelleke, "Should the CEO Be the Chairman?" *MIT Sloan Management Review,* 46(2) 2005, 70-74.

9 Lorsch and Zelleke, "Should the CEO be the chairman?"

a decrease from 39 percent in 2008 (186 companies)—a closer look reveals that only 81 companies of the S&P 500 (or 16 percent in total) have a "truly independent chair."[10] (In the United Kingdom, this number is around 25 percent.) Another report states, "There is no rush to split the role of chairman and CEO. Nonexecutive chairmen are rare, leading only 9 percent of boards in the KFMC [Korn/Ferry Market Cap] 100."[11]

Even a formally independent chair does not necessarily mean that the chair is seen to have independence of mind inside the boardroom by his or her colleagues. Lorsch and Zelleke note one chair's advice: "The wise CEO would make sure that long before it gets to the board, strategy … will be discussed fully with his chairman …, and disagreements will be talked out."[12] Given that only 16 percent of separate chairs are actually independent from the company—most are former CEOs—it is questionable how much formal separation actually translates into independent leadership. This ambiguity compounds the agency and definitional problem already inherent in the board system

No Established Relationship between a Separate Board Chair and Corporate Financial Performance

The link between formal board leadership structure (separate or combined roles) and corporate performance is ambiguous and complex, both theoretically and empirically.[13] No structural attribute of boards has ever been linked consistently to company financial performance.[14]

The current discussion about formal board leadership roles lacks behavioral theories about the board that can extend organizational principles to the boardroom while also reflecting the merits of the agency problem boards face.

Others have previously argued that behaviors and what actually happens inside the boardroom are what lead a particular leadership structure to be effective.[15] We follow in this vein by analyzing qualitative data gathered from the observation of boards and interviews with their directors.

We draw on two qualitative studies—one Canadian and one American—that examine board process through firsthand observation and interviews with directors and consider whether formally separating the roles of chair and CEO necessarily leads to more "effective" board process as defined in each study.[16] Both studies, including ongoing research by one researcher, focus on understanding board process without hypotheses a priori. Neither set out to study board leadership per se, but both uncovered how critically the behaviors and capabilities of the chair (separate or not) affect the process the board adopts in meetings. We use these findings to draw attention to areas that have largely been unexplored in the debate about board leadership structure. We propose that the "pay-off" of separation is actually determined in three arenas that have not received enough attention in governance research: the specific industry knowledge of separate chairs, their leadership skills, and how they shape board process.

The Importance of Board Leadership to Board Effectiveness

One important theme that emerged from our observations and interviews was that the leadership style of the separate or combined chair was an important differentiating factor in how the board worked and also was one of the issues about which directors had strong opinions. (Lead directors were largely ignored because they occurred infrequently and were not leading the board meeting.) So the two researchers paid attention to leadership in meetings and asked about it in interviews. In the American study, two boards had combined chair/CEO roles and three had separated chair/CEO roles. In the Canadian study, the vast majority of the boards studied had separate chair/CEO roles, given the regulatory guidelines advocating role separation.

10 SpencerStuart, "2009 Spencer Stuart Board Index," October 2009.

11 Korn/Ferry Institute, "The Korn/Ferry Market Cap 100: Board leadership at America's most valuable public companies," 2010.

12 Lorsch and Zelleke, "Should the CEO be the chairman?"

13 See, for example, Roshima H. Said, Zuraini Yaacob, Norasmila Awang, Jurina Ismail, Kamaruzaman Jusoff, "Chief Executive Officer duality and company performance: A case of Malaysian companies," *Interdisciplinary Journal of Contemporary Research in Business,* 1(6), 2009, 120-142 at page 124; and Raghavan J.Iyengar and Ernest M. Zampelli, "Self-selection, endogeneity, and the relationship between CEO duality and firm performance," *Strategic Management Journal*, 30(10), 2009, 1092-1112 at 1094. Iyengar and Zampelli state that, "The major empirical literature on the duality-performance relationship over the last 25 years or so has been motivated by one or both of these theoretical perspectives and has yielded equivocal and conflicting results."

14 See Dan R. Dalton and Catherine M. Dalton, "Board of directors: A collision of theories and collapsing applications," in John Boatright (Ed.) *Finance Ethics: Critical Issues in Financial Theory and Practice*, 2010, Hoboken, NJ: John Wiley & Sons, Inc.

15 See, for example, Annie Pye and Andrew Pettigrew. "Studying board context, process and dynamics: Some challenges for the future," *British Journal of Management*, 16(s1): S27-S38, 2005; and Jay W. Lorsch and Elizabeth MacIver, "*Pawns or potentates: The reality of America's corporate boards*," 1989, Boston, Harvard Business School Press.

16 Katharina Pick, Around the boardroom table: Interactional aspects of governance, Ph.D. dissertation, Harvard University, 2007; and Richard Leblanc and James Gillies, *Inside the boardroom: How boards really work and the coming revolution in corporate governance*, 2005, Mississauga, ON: John Wiley & Sons Canada Ltd., which is based on Leblanc's Ph.D. dissertation. The Canadian study is being supplemented by ongoing interviews (2011-2012).

Our findings are separated into two main areas. We first address board process (at a group level of analysis) as an indicator of overall board effectiveness. In the second section, we address the specific attributes of separate chairs that were found to affect group process (at an individual level). Although board effectiveness and chair attributes are interdependent (e.g., board leadership behavior can create conditions for good board discussion, information-sharing and management interaction), they are addressed sequentially in the sections that follow. In our conclusion, we discuss the inherent limitations of separate, nonexecutive chairs.

What Are the Process Dimensions of Board Effectiveness?

Adopting a process approach to understanding boards requires first identifying the aspects of board process that indicate a board is functioning effectively—or more effectively than other boards where these aspects are not present. Three "effectiveness" indicators emerge from the data:

1. Managing dissent
2. Generating a productive group discussion
3. Facilitating a positive board culture, especially the relationship between the board and management (including between the chair and CEO)

How do these three attributes relate to board performance or the quality of governance? To determine this, we follow the example of scholars of decision making.[17] Rather than focusing on a particular outcome—like quality of decision—that is difficult to determine, we focus on the process aspects that are likely to produce a good outcome.

1. Managing dissent

Boards observed and directors interviewed differed in their handling of dissent:

> *"If there is dissent, it's emotional and everybody needs an opportunity to be heard. The chair shouldn't try to force a decision at that point unless it's life or death, but most decisions aren't that way. Where there is often dissent is when management brings something to the board by surprise and the role of the chairman is important here. Preliminary things should have happened to move it forward, such as further information. Dissent might happen when you don't have all the facts or things are premature. Dissent can also be handled between meetings, person-to-person, or over the phone. The chairman may also want to get the board member together with management."* (Separate chair)

> *"It's very important not to have sons of [expletive deleted] on your board."* (Director)

> *"There's a fine line between dissent and [expletive deleted].... I met more [expletive deleted] in the last four years than in the previous thirty.... Yes, you want dissent on your board but you don't need an official opposition."* (Director)

> *"I'm the Wicked Witch of the West. It's not a tactic, but I speak up and don't feel restrained."* (Director)

For some of the boards observed, even minor instances of disagreement became explosive and emotional and could derail further discussion. In others, dissent opened the door to waffling, polite indecision, and delaying important matters. Examples of "explosive" and "waffling" behaviors are provided for illustrative purposes.

Explosive behaviors Directors on one board interacted collegially, often sharing industry information and news about various happenings or players in the company's competitive sphere, until there was a point of challenge, but thereafter tended not to support each other. Instead, directors tended to respond to challenge, particularly when conflict with the CEO ensued, by distancing themselves from the challenger and by discounting the challenge.

While information sharing was nonthreatening, the expression of opinion or criticism could lead directors to turn on each other. In part, their intra-group interactions seemed to be shaped by the responses of the CEO. At times, even seemingly innocuous advice offered by directors was openly construed by the CEO as criticism. There was a palpable tension both among the directors and between the directors and the CEO. It was reflected in the CEO's responses to challenges and questions, often deriding the challenger and reacting defensively. In another instance, during a board meeting of a financial institution with a separate chair who said very little during the meeting, the CEO stood up, paced, and pounded his fists loudly on the boardroom table while shouting to make his point.

17 See e.g., Max H. Bazerman, *Judgment in managerial decision making*, Boston: John Wiley & Sons, 2006.

Waffling The behaviors that characterized this avoidance pattern were an unwillingness not only to reach conclusions by the directors, but also an unwillingness to offer directives as a group for management. There was a great deal of information sharing and discussion, but resistance to resolving conflict.

This board had a lively and lengthy debate among the directors on almost every issue raised during the meeting, with directors contributing from their personal experiences, sharing information, and expressing opinions. However, the norm for ending the discussion was not to reach any conclusion and articulate some consensus, but rather to hand off the debate to managers to do with as they saw fit. During one particular discussion, the new management team had come to the board to make a decision about how to proceed with a particular strategy for managing its stock value. This discussion, like most others, ended not with consensus, but with multiple opinions that were not reconciled or resolved by vote. One director said, "When we get to an ending point in our discussion, we don't necessarily reach an agreement, whether it's unanimous or not. Frequently we seem to table the action and say well we'll talk about it in the future."

In and of themselves, these outcomes were not necessarily "dysfunctional." However, when they are coupled with the directors' frustrations and lack of satisfaction about their own process, they certainly undermined board performance, both then and in future discussions.

Group conflict, as in the form of dissent or disagreement, is sometimes helpful to group decision making and to member commitment to the group.[18] However, it is universally harmful to group outcomes when it is not dealt with properly. Specifically, when conflict turns personal or lingers, it can undermine the group's ability to work together and the effectiveness of discussion and decision making going forward.[19] Decision making is one of the board's most critical tasks, and trust and collaboration is needed for boards to be responsible and reliable in their duties.

18 See, for example, J. Edward Russo and Paul J.H. Schoemaker, *Winning decisions.* New York: Random House, 2002; and Michael Useem, How well-run boards make decisions, *Harvard Business Review,* 84(11): 130-138, 2006.

19 See, for example, Chris Argyris, "Interpersonal barriers to decision making," *Harvard Business School on decision making*. Boston: Harvard Business School Publishing: 59-95, at page 78, 2001, and Stephen J. Hoch and Howard C. Kunreuther, (Eds.) *Wharton on Making Decisions.* New York: Wiley & Sons, at page 187, 2001.

2. Generating productive group discussion

Boards need to be able to draw on the resources and expertise assembled in the room, but like all time-constrained groups, they must balance discussion with efficiency. When discussions become inefficient, group members get frustrated and disengage. However, when they are not involved and feel as though their contributions are not valued or will not make a difference, they similarly are likely to disengage.

What constitutes a *productive* discussion? The definition of "productive" used here was determined through observation and the directors' own accounts. The definition reflects both substantive matters and their subjective experience of the quality of group process. For the observation of productivity, issues of participation (Did the directors participate equally? Did everyone who said they had something to say actually get to say it?), information sharing (How much information did directors share? Did directors get answers to their questions?), and conflict resolution, which is critical because the data analysis focused around points of conflict (When a director raised a challenge to a particular course of action, how was it resolved? Was it resolved?).

In the sample observed, there were boards where directors actively contributed to discussions, both by sharing their expertise and by asking questions viewed as relevant by other directors. Directors would incorporate prior points into their own contributions, overtly building on each other's thoughts and drawing directors into discussions. In other, less "effective" boards, directors believed that information and questions were being repeated or points were being made simply to be made. A quote from one director illustrates the point: "He always has to throw zingers. It's just the way he is."

In other words, boards that had productive discussion made use of the expertise on the board, shared information that was not already held by all members of the group, and were not dominated by only a few, loud voices. Directors built on each other's points and spoke directly to each other rather than only speaking with management or the CEO. Boards that did not share these qualities had very little discussion or information sharing, lacked director-director interactions, and lost opportunities to hear opinions from directors who had expertise.

Another important aspect of advancing "productive" board discussion was the demonstrated capacity by directors to disagree, but doing so in a manner that invited engagement and trust rather than inspired antagonism or defensiveness. According to interviews and observation data, the specific words used, the tone, the body language, and the timing and frequency of the disagreement were factors that characterized constructive challenges that strengthened group discussions and potentially enhanced decision-making outcomes.

Board leadership (separate or not) was observed to play a critical role in productive group discussion when the board leader actively defined the norms in the group, the process of discussion (e.g., which director speaks, in what order, etc.), the structure of discussion (what comes first and when a discussion closes), and how the board understands its role in a particular discussion (the way the board leader frames the discussion for the other directors).

3. The relationship between the board and management

Some of the boards observed had a culture where asking tough questions of management was the norm and directors were not criticized for being adversarial. "Tough" questions occurred when directors asked questions about assumptions or substantive content that related to the issues being discussed and required management to justify or explain their reasoning and positions. Some boards asked minimal or few questions during observation periods (including those with separate chairs) and a few contained directors who fell asleep at meetings and either did not open their board materials or consulted them minimally when observed. Other directors asked only simple clarifying or perfunctory questions.

The relationship between management and the board is inherently strained since one body is monitoring the other. However, some of the boards observed channeled this natural tension into a more constructive dialogue rather than a hampered, adversarial one. These boards were able to operate in a (flexible) gray area between being monitors and advisors to management, whereas others appeared to slot themselves into one role or the other, particularly when there was a moment of conflict in the boardroom.

Nonexecutive Chairs Are Not Inherently More Effective

In both the American and Canadian studies, the foregoing three aspects of board process—managing dissent, generating a productive group discussion, and managing the relationship between the board and management—were present under both separate and combined board leadership structures. Strikingly, in the American study, the two boards that had the most problematic interactions in terms of directors becoming frustrated by a lack of direction or a strained relationship with management had separate chairs. Equally interesting is that, of the two leaders that exhibited the most similar approach to managing director input and board-management relations, one was a separate chair and one was a chair/CEO. [20] Moreover, one of the boards that had the most tough-minded and challenging interactions from directors was lead by a combined chair/CEO.

In the Canadian study, the data were similar. There were examples of separate chairs viewed by colleagues as being ineffective—termed "caretaker-chairs" by the researcher. As for "conductor-chairs" (chairs viewed as effective by peers), their success appeared to be unrelated to whether the chair was separate or combined with the CEO role.

Interviewees had a wide range of opinions on "caretaker" (ineffective) and "conductor" (effective) chairs and the decision to separate roles:

> *"Look at the successes for nonexecutive chairmen.... We should pick someone who has the requisite skills already versus training on the job.... Not just the time and availability, but the skill set that the job requires. We should recruit chairmen of boards with this in mind."* (Director)

> *"There should be a [expletive deleted] course for chairmen to take on how to run a [expletive deleted] board meeting."* (Director)

> *"A chair should move things forward by consensus. Once you know the facts and directors' points of view, you go one-on-one first. It's time-consuming."* (Chair and CEO)

20 K. Pick, supra note 16, at page 161.

"The right chairman creates the right atmosphere. With the wrong chairman, it's completely different." (Director)

"Chair versus CEO? You can have the opposites with both outstanding results. There are many different models of how to get things done successfully without following a script. It depends on the personalities, history, and mix, and you can't qualify this, so you need to leave something of discretion to the guys involved." (Chair)

"You need to tailor the situation [chair and CEO] to the people and personalities involved … the circumstances of the company and personalities of the company. In some situations, you might want both roles in one person or it doesn't matter." (CEO)

Therefore, when we consider all of the believed advantages of a separate chair from an independence perspective, the requirements for the chair to be effective appear go beyond role separation.

Factors That Contribute to the Effectiveness of a Nonexecutive Chair

Others before us have argued that the chair is perhaps the single most important determinant of how a board functions. For example, Sir Adrian Cadbury states:

"Although board chairmen have no statutory position, the choice of who is to fill that post is crucial to board effectiveness. Broadening the point, when we attend a meeting of any kind, we can almost sense from the start whether the chairman is competent or not… Continuity and competence of chairmanship is vital to the contribution which boards make to their companies. The lead which boards are there to give to their companies, stems from the leadership which chairmen give to their boards."[21]

The "competence of chairmanship" Cadbury describes was discernible in our boardroom observation. Concentrating particularly on those chairs who were separate, it was evident that simply being "separate" did not necessarily enable the chair to produce good process. In several instances, being a separate chair seemed to undermine the chair's ability to lead the board. Some strong nonexecutive chairs, as observed and viewed by directors, were adept at creating and managing discussion, letting it meander when desired and taking a strong role in pushing it forward when necessary. They were able to understand and sense important areas of disagreement and draw out dissent without letting it undermine board process. For example, separate chairs stated during board meetings:

"Some people thought it might be …, but perhaps I'm wrong about that and it can work. But we'll have to come back to that and make a decision." (Separate chair)

"I don't want to vote but we need consensus.… Let's walk a middle road.… Do I have support?… Have we reached consensus? Okay, everybody?" (Separate chair)

These nonexecutive chairs appeared to manage the agenda and conversation so both management and board concerns were heard, and they carefully sustained an open and positive relationship between the directors and management. Other separate chairs were not nearly so effective, viewed by board colleagues as letting conflict spill over and grow from meeting to meeting, leaving some directors uninvolved (and others overinvolved) in discussion, and allowing vague and confusing (if not adversarial) communication between the board and management. Consider the following quotes about ineffective separate chairs:

"[The separate chair's] problem is that he doesn't do anything and he can't run a board meeting." (CEO)

"We went out of our way to hire … [the separate chair] because of his credibility. He's well-paid but completely useless.… He's disgusting, greedy, and outrageous, and other board members agree.…" (Director)

21 Adrian Cadbury, "*Corporate governance and chairmanship: A personal view,*" Oxford University Press, 2002, at page 35.

Three Traits of Effective Nonexecutive Chairs

Through deep description, repeated observation, and consultation with key informants, we identified three criteria possessed by separate chairs that appeared to "make the difference" for them and their colleagues in leading their boards towards a sustainable, effective group process:

1 Industry knowledge

2 Leadership skills

3 Attention to board process

1. Industry Knowledge of the Board Chair

Nonexecutive chairs who were also excellent board leaders all appeared to possess a high degree of industry knowledge. They may have had long successful careers in the industry of the company whose board they were leading. We examine how this competency factored into board process.

A nonexecutive chair, even when he or she was not the most senior person on the board, was able to interrupt and guide the group discussion when necessary. One practice repeatedly observed in particular was that separate chairs consistently frame discussion points, adeptly and independent from management, to begin and close discussions. This type of chair articulated the particular issue and role of the board, the kind of input needed, and grounded the discussion topic in the larger task and aim of the board from a governance standpoint. Accomplishing this highly complex task in real time requires possession of industry and company knowledge.

These practices helped produce efficient and constructive discussion because directors knew how to contribute individually and appeared to be collectively focused on a clear task and were not trying to discern how deep or broad their remarks should be. In other boards, the ambiguity of roles that is inherent in board work often led to frustrated directors and management, meandering discussion, tensions about what input is appropriate, and slow, vague decision making.

Why was industry competency so important to this real-time dynamic? Because both directors and management expressed such high respect for the chair's experience and trusted that his or her input would be well-informed and relevant. Directors paid attention to the chair's input, even when the input was strictly about the process of the board meeting. In one board, for example, both the directors and management noted their good fortune in having a separate chair so well-respected within and knowledgeable about the company's industry.

In contrast, some nonexecutive chairs were hampered precisely by their lack of industry competency and reluctance or inability to become informed. These chairs had difficulty establishing credibility with the other directors, lacked understanding of the business model, and could not adequately keep discussions on track. This may also have been a matter of leadership skill, but overall, a lack of industry competency made it difficult for a separate chair to establish legitimacy with the directors and management team in a way that allowed him or her to meaningfully shape the board discussion. In several instances, directors simply believed that what they were contributing at the moment was more important to the board's work than any attempt to speak or steer the process. This kind of separate chair becomes "just" the meeting leader, an administrator to walk the board through the agenda. However, because the chair has no relevant industry competency or particular status in this regard, it is difficult to even to be an effective administrator. The lack of industry competence does not go unnoticed, even by a first-time observer.

Industry competence is important in another respect. When the chair was respected in the industry, it appeared to ease the relationship between management and the board, and particularly the CEO and the board. This may not be entirely intuitive, but in the boards observed, because the CEO had respect for the chair and there was observable chemistry between them, the chair's role at the board meetings did not undermine the status and management leadership of the CEO. Of course, this legitimacy also depended on the separate chair's behavior, particularly his or her leadership skills and the sensitivity with which interactions with the CEO and management in and outside of the board meeting were handled. A nonexecutive chair with little or no industry competency was observed to be more likely to be circumvented or pleasantly tolerated but managed by the CEO (in one instance, the CEO was said to "own" the chair), rather than a good, reliable liaison and mentor between the board and the CEO. The relationship between the chair and CEO is important and likely to be productive when there is mutual respect and shared context and knowledge.[22]

22 See, for example,Elise Walton, "The Effective Chair-CEO Relationship," The Corporate Board, May/June 2011: 15-22; Mary K. Totten and James E. Orlikoff, The CEO-board chair partnership. *Trustee,* 60(7) 2007: 17-20; Richard Hossack, "Together at the top: The critical relationship between the chairman and the CEO," *Ivey Business Journal,* January/February: 1-4, 2006; and Andrew Kakabadse, Nada K. Kakabadse and Ruth Barratt, "Chairman and chief executive officer (CEO): That sacred and secret relationship," *Journal of Management Development*, 25(2): 2006, 134-150.

A third, perhaps more obvious reason industry knowledge was important to effective board leadership is that it provides access to important resources. These chairs were able to link the board and management to vital information, insight into past strategic successes or technologies at other companies, and potential business partners, employees, and additional board members. This advantage provided a clear signal to management and to other directors.

2. Leadership Skills of the Board Chair

A second defining characteristic of the successful nonexecutive chairs was that they each possessed the leadership skills and style that allowed them to exert influence and maintain legitimacy in the boardroom. Broadly speaking, among the most important leadership skills that we identified for separate chairs were acting with the utmost integrity, the capacity to constructively challenge unemotionally, the ability to build consensus among a diverse group, the ability to communicate effectively across differing styles, the ability to create a common vision, the ability to give unvarnished feedback to the CEO (including in private session), and the ability to coach and develop the CEO and other directors.

The effective chairs were leaders in other contexts and were viewed as such by their board colleagues and management. For example, they were said by peers to have extraordinarily well-developed interpersonal or "people" skills, be very good listeners and communicators, take leadership on relevant issues, commit the time to see issues through to fruition, and have the ability to solicit support and respect from other directors and management in doing so. They were observed to assert themselves in board discussions skillfully, with impact, adeptness, and influence, even when the momentum of a particular debate was moving strongly in one direction. One management representative, for example, said:

> *"A skillful chair, therefore, is a referee, moderator, and smoothly slips in his own views. They bring a sense of discipline to the discussion. They cut people off nicely and set a time limit to the agenda."* (Management)

These nonexecutive chairs also led by example, established boardroom norms and accountability expectations, and addressed director under-performance issues.

LEADERSHIP SKILLS VS. INDUSTRY KNOWLEDGE: WHICH IS MORE IMPORTANT IN A BOARD CHAIR?

In comparing leadership skills with industry knowledge, the question arises about which is the more important of the two in the context of recruiting (or replacing) a separate chair. Also, can one or both of these competencies be learned?

A definition for competency is "a cluster of related knowledge, skills, and attitudes that affect a major part of one's job (a role or responsibility), that correlates with performance on the job, that can be measured against well-accepted standards, and that can be improved via training and development."[23] A competency therefore can be improved via training and development. Sir David Walker, in his wide-ranging report on the corporate governance of U.K. banks, remarked that:

> *"A new chairman of plainly considerable ability but with less than the desired financial industry experience might be assisted through a rigorous tailored induction and training programme to move up the industry learning curve relatively quickly (similar to that proposed for NEDs [nonexecutive directors] earlier). But what may be characterized as the vital chairman leadership skills, if not already demonstrated at the time of appointment, might not be as readily acquired if a candidate does not already have them. A bank board, the regulator and shareholders in a major BOFI [banks and other financial institutions] cannot afford to rely on a process of "learning leadership on the job."*[24]

Walker's view that leadership skills of a nonexecutive chair may not be readily learned, but may instead be an inherent characteristic attribute or quality acquired or developed as a result of past history or experience, is consistent with our data. No separate chair observed appeared to acquire leadership skills during the course of observation or interviews when they were observed or believed not to possess such leadership skills at the outset, in the view of fellow directors.

23 Scott B. Parry, "Just what is a competency? (And why should you care?)" *Training,* June 1998: 58-64.

24 David Walker, *A review of corporate governance in UK banks and other financial industry entities Final recommendations,* issued November 26, 2009, p. 59 (www.hm-treasury.gov.uk/d/walker_review_261109.pdf).

The inference that industry knowledge may be improved over time but leadership skills less so has implications for the selection (and removal) of separate chairs:

- A chair without desired leadership skills should be promptly replaced or not appointed to begin with; and
- A prospective chair not from the industry but with necessary leadership skills can acquire industry expertise, with effort and time invested.

3. Attention to board process by the board chair

Finally, each of the successful nonexecutive chairs observed employed their industry knowledge and leadership skills by making a pointed and sustained effort to manage board process, including board meetings and informal interaction outside of meetings. In other words, they were deliberate and thoughtful about how to solicit input, how to encourage dissent but build consensus at the same time, and how to create a common sense of purpose. In doing so, they were knowledgeable about the potential tendencies of groupthink and the practicalities of board work. They believed that the *way* the board worked together was critical to the quality of governance it could produce.

The pieces of board process effective nonexecutive chairs were most adept in devoting their attention to included contributing to the establishment of effective agendas, information flow and reporting expectations, encouraging even and shared participation among their board, understanding and utilizing the competencies and commitment of fellow directors, anticipating and adjusting for potential style clashes among board members or with management, preventing rapid consensus on major issues, knowing when to push towards consensus, leading the executive session and board meetings, managing time and expectations around time, and framing discussion points to keep the board on track.

Inherent Limitations of Nonexecutive Chairs

To summarize, both leadership structures (combined and separate CEO and chair roles) were viewed by directors as being effective in both the American and Canadian studies. A particular leadership structure did not appear either to prevent an individual from being seen to lead effectively or to ensure effective leadership.

As explained above, however, the role of a separate chair is inherently difficult. The separate chair must have a kind of legitimacy with the director group—based on industry knowledge, attention to boardroom process, and, perhaps most important, leadership skills—that is usually not questioned in a combined chair/CEO. Although lead directors were not examined directly in this study, there is no reason to believe that some of the attributes of an effective separate chair may also apply to a lead director. However, caution is in order, as the roles of a separate chair and a lead director with a combined chair and CEO are different. A separate chair has authority with the office that a lead director does not, which includes the ability to influence the agenda and chairing of regular board meetings.

Second, the separate chair must develop a strong and trusting relationship with the CEO, a difficult task when either the CEO or the chair is unwilling and/or the chair does not have the credibility among the other board members for the CEO to "have the chair onside."[25] In other words, the effectiveness of the separate chair setup appears to be much more dependent on a series of relational and individual attributes than its advocates often acknowledge.

25 "Onside" is understood to mean that the chair has consented to the matter reaching the board, not that the chair has decided on or unduly influenced the matter prior to this. As one chair of three boards put it recently, "And it took a while for me to get my mind around the fact that the Board Chair is not the Chief Executive Officer of the Board, but only one of the members of the Board who happens to have the responsibility of managing the meeting… I came to appreciate that the best chairs are the ones who regard themselves as the least important member of the Board of Directors, in terms of participation in the meetings. Because that's how you get the maximum participation from your Board members, is to not take a leadership position. And to not disclose what your inclinations or views are, because it adversely affects the whole of the meeting." Skilled CEOs however, will attempt to co-opt the Chair into pre-approving or endorsing a matter and thus compromising the Chair's independence and affecting the debate in the boardroom.

Practitioner and Policy Implications

The examination of competencies and other attributes of nonexecutive chairs requires greater research attention.[26] Given the importance of industry, leadership, and process competencies in a nonexecutive chair, the role, responsibilities, profile, and process by which a separate chair is selected should be developed with the desired capabilities and behaviors in mind.[27] Our findings suggest that being able to identify someone who possesses these competencies should inform the decision of whether or not to separate the chair/CEO roles.

A board should not be unduly influenced (e.g., by governance rating agencies) or caught off guard in way that causes them reactively to select a chair simply to fill the separate role. It is entirely appropriate to disclose to shareholders that leadership duality (a combined chair and CEO) is preferred in given circumstances.

Mere Role Separation is Inadequate to Ensure Effective Board Leadership

This study's findings suggest that policy making and shareholder guidelines focusing primarily on the separation of the chair and CEO roles may omit a key dimension of effective board leadership. The focus instead should be on the effectiveness of the prospective or incumbent chair of the board. Also, it may be reasonable to ask whether separation should ever be more than temporary. If there is no appropriate person on the board to fill the role, the board may be better off adopting a unified structure (perhaps with a lead director) rather than forcing themselves into a separate structure.

26 See, for example, Alessandro Zattoni and Francesca F. Cuomo, "How independent, competent and incentivized should nonexecutive directors be? An empirical investigation of good governance codes," British Journal of Management, 21(1): 63-79, 2010; Duncan Neill andVictor Dulewicz, Inside the "black box": the performance of boards of directors of unlisted companies. Corporate Governance, 10(3): 293-306, 2010; and Morten Huse, "Accountability and creating accountability: A framework for exploring behavioral perspectives of corporate governance," British Journal of Management, 16(s1): S65-S79, 2005.

27 See, for example, Charles Elson, *et. al.*, "The 'great divide' makes for a great debate: A panel of experts tackles whether to separate the chairman and CEO roles," *Directors & Boards,* First quarter 2010: 21-28, 2010; Dennis Care, John J. Keller and Michael Patsalos-Fox, "How to choose the right nonexecutive board leader," *McKinsey Quarterly,* 1-5, May 2010; Victor Dulewicz, Keith Gay and Bernard Taylor, "What makes an outstanding chairman? Findings from the UK nonexecutive director of the year awards, 2006," *Corporate Governance: An International Review*, 15(6): 1056-1069, 2007; and Susan S. Stratton, "Board orientation and board culture," *The Corporate Board,* September/October: 21-25, 2005.

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