GRESHAM

COLLEGE

GOVERNANCE

Lecture 2

THE CHAIRMAN AND THE CHIEF EXECUTIVE

by

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GOVERNANCE:

The Chairman and the Chief Executive

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In my last lecture, I discussed the role of the Board with two colleagues, Brandon Gough and Peter Morgan, and in my continued study of Governance, my theme for this year's lectures, and I turn to the roles and relationship of the Chairman and Chief Executive, a subject which lies at the very heart of corporate leadership. My intention as I expressed it last time is to deal if at all possible with difficult issues which are not directly addressed by the prescriptive codes laid down by the Cadbury, Greenbury and Hampel committees.

[Guests]

The rules remain the same: a few minutes from me, a brief commentary from each of my guests and then open forum.

In my career, I have known many Chairmen, some strong and assertive, some laid back to the point of invisibility, but effective nonetheless – and I have known some appalling ones. I will not go much further on the latter, since parliamentary privilege does not extend to Gresham College....

Equally I have known some very fine Chief Executives, discharging their roles in a variety of ways and highly successfully, and some who were completely out of their depth. Here too my lips are sealed.

The common theme is that success and effectiveness in these roles does not come in easily defined form, any more than the character of individual human beings can be crammed into some narrow framework. What however is interesting and will be I hope an underlying theme of this evening is the interrelationship and interplay between the two, which in my mind is critical to success. But I do firmly believe that a talented and effective CEO can be hindered perhaps to the point of failure by a second-rate Chairman, and vice versa.

A note of political correctness before I start, if I may. Please assume that when I refer to Chairmen, my remarks apply equally to female holders of the office. Such things as Chairs and Chairpeople have not yet come into mainstream usage in the corporate environment. I shall therefore stick to the contemporary vernacular.

The respective roles

The subject is perhaps best approached by looking at some key functions performed jointly or severally by the two positions.

In exactly the same way as I argued at my last lecture that ultimately, important as many stakeholders are, it is, within the law, the shareholders of a company that are paramount – so it is important to realise that in the corporate pyramid the Chairman is at the pinnacle. The Board is elected by the shareholders and he is elected by the Board, but as something more than primus inter pares. The CEO is appointed by the Board, but of course the Chairman will have a leading and highly influential role in his selection, management, appraisal and where necessary dismissal. To all intents and purposes, the Chairman is the CEO's boss, the ultimate leader of the organisation, and of course a key part of this role is to represent the Board between its formal meetings.

Moving on I believe that it is the principal responsibility of the Chairman to create, always with the endorsement of the Board itself, the framework – by which I mean Board role and governance, strategy and strategic objectives, and top level organisation – within which the organisation functions. In contrast it is the principal responsibility of the Chief Executive to work within that framework to achieve the corporate objectives. It is he who pulls the levers provided for him by the Board and its Chairman, supervising not just day to day activities, but also the implementation of strategic decisions too.

Surprisingly often glossed over, literally chairing the Board is at the heart of Chairman's role and indeed skill, particularly when facing difficult decisions and/or a large, divided and fractious Board. Many a fine man has brought great ability to the job, but lost his authority and effectiveness at the Board table. All the outstanding Chairmen that I have known took much of their power from their handling of Board meetings, and without exception all the bad ones simply couldn't cope.

The qualities of a good Chairman

It would take yet another lecture to opine fully on the subject, but I would set out the following as some guidelines for good chairmanship at the Board table: an objective, open mind, but a clear idea of where the debate ought to go; an ability to ensure that the key issues are raised and that all who can do participate, but an intolerance for deviation, longwindedness, bandstanding and repetition; an ability to derive consensus where it is available, but not at the expense of weak or fudged decisions; a keen eye for body language and a sensitivity to other's reactions; a knowledge of the likely position of all participants on any contentious issue; an ability to lead and steer, but not to dominate; an ability to know when to be firm and when to let the discussion run, and above all when to guillotine a debate. To which I can only add the point which I made at my last lecture: any board meeting which lasts more than 3 hours is well into extra time, given the powers of concentration and intellectual stamina of most human beings.

So much for SuperChairman. In practice no Chairman can possibly aspire to all these attributes at all times, but most of them are necessary a great deal of the time. One great

Chairman I know – still going strong – used to like to harangue the Board: territorial advantage Chairman 90%, The Rest 10%. But he was still highly effective.

I rather suspect it was because he was a dab hand at the related role, that of the subtly different skill of managing the Board outside the Boardroom, which is a key extension of Chairmanship at the Board table. Boards, as I said at my last lecture, are organic creatures with differing balances of executive and non-executive representation, as well a depth and range of character and attitude. Two hours of success at a Board meeting may require many more vitally important hours of communication, discussion, listening, learning and persuading outside the Board room. In handling difficult matters it is vital that all participants fully understand the issues, that the Chairman at least has a fair idea of where each Board member is likely to come from in the debate at the Board table, and often that a consensus has been pre-established

Equally Board management can be the critical factor which determines the success of a Chairmanship. LIFFE's constitution as originally conceived by its founding fathers envisaged a very non-executive, unpaid in fact, Chairman, who would do little more than chair the Board and represent the Exchange on public occasions. However it became clear during my time as CEO if not before that the role involved a great deal more than that. The strategic outlook was increasingly complex, attitudes from the various constituencies of the Exchange more varied if not opposed, and the external communications and diplomatic demands of a global financial institution increasingly in a goldfish bowl. Furthermore the shareholders, the members of the LIFFE cooperative, wanted more involvement and consultation in the development of strategy, alongside the constitutional role of the Board. It was obvious that the job could not be done on the basis of a few hours a week, and that it had become a fulltime responsibility. I and others campaigned for a fulltime Chairman as a complement and boss to me as CEO, and this was finally agreed by the members just before I left.

The LIFFE experience emphasises a key point. It is much more difficult for a CEO, who after all is charged with managing the business and bringing issues up to the Board; and will often, rightly indeed, be seen to have an angle. So it was in my case with LIFFE where it was often the case that when I attempted to have an objective and rational discussion with a Board colleague on an issue of fundamental import to the Exchange, the latter immediately went into suspicious market trader mode, trying to work out whether I was buying or selling.

Who is the guardian of corporate strategy?

Consistent also with the framework notion is my firm belief that it is the Chairman and not the Chief Executive who is the guardian of corporate strategy. Although, as I have argued at my previous lecture, the actual strategic decision-making is the central function of the Board as a whole, the protracted process of the development of corporate strategy, the agreements of the strategic objectives that this entails, and the more detailed strategic decisions involved must be done under the supervision of the Chairman, although he will naturally leave the development of the details and implementation to the CEO, with whom he will in any event collaborate closely. However is to my mind one of the single greatest failures of corporate governance today that it is comparatively rarely the Chairman who takes the rap for the failure of corporate strategy, when presumably it is he who has – or certainly should have – presided over the process by which it has been created and (clearly unsuccessfully) implemented.

I move now to the organisational and managerial aspects of the role of Chairman. The prime responsibility is of course in the appointment of the Chief Executive himself, and indeed there are some schools of thought which have it that the sole responsibility of the Chairman is to ensure that the right CEO is in place; having done so, it is argued, a non-executive Chairman can put his feet up and relax. It is certainly true that the CEO's appointment is probably the single most important one the Board can make – but only just ahead of that of the Chairman himself – and that the Chairman's hand in the process will be crucial. It is certainly up to the latter to take the lead in ensuring that the right senior structure is in place. But it is also important that, whilst keeping an eye on the activity, the CEO is given the right in principle to build up his own team. An exception might be the Company Secretary, who has a fascinating role in the governance of any corporate body, and a Chairman would do well to take a particularly close interest in the appointment of the Finance Director.

How important are the dynamics between CEO and Chairman?

In reality however the appointment of the Chief Executive is just the beginning of the story, for the success of the business will now depend critically on the dynamics of the relationship between CEO and Chairman. It is essential at the outset that the roles are structured complementarily and are not seen to overlap to any degree, and that this clearly defined balance is explicitly agreed between the two parties. The Chairman who likes to dabble in day to day affairs is as dangerous as the CEO who always lives on the strategic level and never gets round to running the business. The personal relationship need not be close, but it should be professional, with a high degree of mutual respect for each other's business abilities. In practice the Chairman is the slightly senior partner and his input to the partnership will be characterised by wisdom, foresight, counsel and warning.

One important activity which falls to a greater or lesser degree to both Chairman and Chief Executive is that of a senior corporate spokesman, to the media, trade, general or financial, and of course to the investing public. But it is also important to agree which of the two should take the lead and to respect that choice. It is a not always totally pleasant characteristics of very senior executives that they enjoy the limelight that stems from such duties, and jealousies can arise if it is not clear who bears the ultimate responsibility. In my mind it ought, prima facie, to be the CEO takes the lead in communications, because it does often require a more detailed knowledge of the business than the Chairman may have, particularly to trade press, constant and instant availability, and it is easier for a Chairman to control a CEO who lets fame go to his head, than the reverse. In practice of course much will turn on aptitude and time availability, but the Chairman of a public company who thinks that he can duck the financial media at least is living in a different age.

Is there such a thing as a Non-executive Chairman?

What does this mean to the Chairman's time commitment to the business? So far as the interaction with the Chief Executive is concerned, a good, well informed partnership will take comparatively little time. In my own Chairmanships, I believe in a formal meeting once a week with the CEO to go over all the issues of the moment, and I also believe in supplementing and assisting the efficacy of that meeting by making sure that I understand what is going on by informal contact with the senior managers and by receipt of regular financial and other management information including the minutes of senior committees.

Nor will the physical act of chairing the Board take much time beyond the Board meeting itself. But the idea of just turning up to Chair the Board, to have occasional meetings with the CEO, and a pleasurable lunch in the City every now and then is to misunderstand and totally to underestimate the importance of the role of Chairman. His guardianship of the business strategy, whilst probably sporadic in nature can take a great deal of intensive input from time to time – the preparation for a strategic away-day, an acquisition or disposal, or a radical change of strategy for instance; as can his role in a major crisis – a forced change in senior management (all too often in recent history he has found himself doing the job), an environmental disaster, an unexpected downgrading in results expectations; and perhaps most of all the key importance as discussed above of effective Board management outside the Boardroom.

It is the possibility of such occasional hyperactivity which has led to the hackneyed expression that there is no such thing as a non-executive Chairman, and which to my mind justifies his higher per diem remuneration. His time is constantly at risk, and he must make himself available when circumstances require.

Indeed there are a number of corporate situations where the role can expand to become close or actually fulltime, even with a fulltime CEO in train; or it can have such characteristics for a limited period. I had the good fortune to serve under two close to fulltime Chairman when I was on the Board of the Post Office: the constant governmental and union interaction made such an extended job spec a necessity. And I referred earlier to the burdens falling on the shoulders of LIFFE Chairmen.

Who appraises the Chairman?

One issue which is an essential part of the role of the Chairman is of course the appraisal of the CEO. This is in most cases a well worn and usually annual routine involving an initial assessment by the Remuneration Committee, communicated by the Chairman, who will presumably if he has been doing his job effectively have providing an informal running appraisal as part of his regular contact with the CEO.

However, as I argued in my last lecture, it is also appropriate, but rare, to appraise the Chairman, a difficult role best performed by the Senior Non-Executive Director – an important role emerging from recent governance codes – after consultation with his other non-executive colleagues. If as I argue the Chairman's role is as crucial as that of the CEO why should he not receive formal feedback on his performance? It could, as with appraisal of all executives, only serve but to improve the management of the business, and it would of course be the opportunity at the extreme to move if necessary and desirable towards the stepping down of the individual from the Chair.

Can the roles be combined?

Can the role of the Chairman and CEO be combined? I have to say that it is my view that they cannot, other than in exceptional and temporary circumstances, such as when the Chairman steps into a dismissed or resigning CEO's shoes. There is simply too much to be done in between the two roles, although I accept that few Chairman in reality have close to fulltime roles.

There are a number of obvious conflicts of interest, too. How can a combined Chairman and CEO chair a Board which may be critical of his discharge of his executive responsibilities? How can he equally sit in the Chair when the Board is attempting to take an objective view on a strategic initiative which he has developed, albeit within a framework developed and approved by the Board and to which he and his executive colleagues are committed? To whom can he turn when he is need of guidance and advice in a patch of turbulent corporate water? Will he frankly have the time to do all that is needed by both roles. The fact is that a combined Chairman/CEO represents unstable equilibrium and tends to defy the checks and balances which should be a dynamic feature of most Boards.

When are CEOs and Chairmen into extra time?

Let me end on perhaps the most controversial issue of all: the departure, voluntarily or involuntarily of either Chairman or CEO. A totally underexposed point is the correct term for either office. There is one school of thought which is content to let either office holder stay in post for as long as they appear successful or desire themselves, but there are in my mind powerful arguments for suggesting that in today's world of the new economy, where change is endemic and rapid, that terms should be finite, understood to be so, and should be respected. In the case of the CEO, it is usually the rule that the fresh vision and objectivity which recent appointments bring to the job is a feature of the first two years, when to some degree the job is also being learned. It is during that time that radical change is usually planned and executed. The next two years may then be spent consolidating, although the business in the nature of today's cycles will be moving towards the need for another overhaul. It is much less easy for this to be carried out by the individual who has in effect created the status quo, and in any event he may have naturally moved to be too close to the business and may even be becoming stale. I well remember when I was grappling with huge internal and external forces during my last year at LIFFE that a head-hunter friend of mine confided to me that no CEO should stay in office more than four years. He was perhaps a tad conflicted in this opinion given his profession, and I told him ruefully that I wished that he had told me that a year before. But corporate history makes it clear that his was indeed a wise judgement. My conclusion is that both the individual and those judging his performance would do well to ask on regular intervals around or after his fourth year whether he should continue in office.

It is hard not to apply the same arguments to Chairmen, particularly in respect of strategic change. However theirs is in most cases a more objective less totally immersing role and so the risk of staleness or diminishing vision is probably less a problem except perhaps in the case of executive chairmen. Furthermore a longer term brings greater wisdom about the business and also continuity. On the other hand a non-executive Chairman will in any event be subject to the increasingly applied rule of restricting the terms to no more than two three year terms for NEDs. Given that most non-executive Chairman come to office after a little time serving on the Board anyway, it would be my view that Chairman and/ or their colleagues should regularly challenge why they should not stand down after 5 years.

I turn now to forced departure and the circumstances surrounding it. Why does it occur and when is the possible need for a change spotted? In the case of the CEO, the judgement on performance is very much that of the Board led by the Chairman, although precise timing of the decision to let the individual go will vary. Often it is preceded by a sense jointly or severally amongst NEDs that something, hard to put one's finger on, is imperfect. It is worth of course saying again that a good Chairman as part of his regular round will see early that things are potentially awry and will build if necessary on that judgement.

There are many reasons for such a departure for operational reasons, based foursquare on the individual's failure to carry out his day to day operating and strategy execution role. But how many times is the departure of the CEO in reality a sign of the failure of the Board, or indeed the Chairman? If the root cause of so many dismissals is indeed a major strategic error, it is worth remembering, before pointing the finger of blame, that strategy is the specific province of the Board, and certainly in my model specifically that of the Chairman. Indeed the Board may have been mismanaged or have comported itself in such a way as to make the CEO's job impossible. Or the Board may quite simply have appointed a talented and able individual but one not suited to the job. In both the latter cases blame should often be placed firmly at the Board's and specifically the Chairman's door.

Are there therefore more times when the Chairman rather than the CEO should go in the event of major corporate upheaval? I believe that there are, and that it is the duty of the Senior Non Executive Director to ensure that if there has to be an execution, it is the right person who loses his head. In an open and responsible corporate environment, why should this not be so? But how often is it, in reality?

My main propositions again:

- The Chairman's principal responsibilities are to create the framework, Board role and governance, strategy and strategic objectives, and top level organisation within which the organisation functions, while it is the principal responsibility of the CEO to work within that framework to achieve the corporate objectives.

- Effectively chairing the Board and Board management outside the boardroom are crucial to the Chairman's success
- The quality of relationship between Chairman and CEO is critical
- Top level communications whilst shared are probably more the responsibility of the CEO
- The role of Chairman and CEO should never be combined other than in exceptional and temporary circumstances
- A CEO must consider himself in extra time after 4 years in the job, and a Chairman after 5.
- A Chairman should be appraised regularly and should be subject to the same sanctions for non-performance as a CEO, particularly where a failure of strategy is evident.

Over to my distinguished guests...

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