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Board leadership

Board perspectives

Companies and investors continue to grapple with what constitutes the optimal leadership structure for boards. During the 2018 proxy season, shareholder proposals requesting separation of the CEO and chair roles (or an independent board chair) were once again among the most common governance proposals. Consistent with prior years, the proposals fared well, averaging 32 percent support, but none passed.[1] These results highlight that investors have mixed views on board leadership. They also demonstrate that having a lead director—an independent director who serves as the representative of the independent directors and as a counterweight to a combined chair/CEO—can satisfy investors seeking independent board leadership if the lead director has robust and well-defined responsibilities.

Prior to the scandals that gave rise to the Sarbanes-Oxley and Dodd-Frank Acts, one individual typically served as both CEO and chair at U.S. public companies. Yet, combined roles raise complicated conflict of interest issues on matters such as executive compensation and CEO succession, since the primary role of the board is overseeing management. At the same time, it is not clear that splitting the roles leads to better performance or governance quality,[2] and splitting presents the potential for the CEO and chair to duplicate efforts or work at cross purposes while sowing internal confusion. Thus, each board should review its leadership structure in light of current circumstances and then disclose in its proxy statement the rationale for combining or splitting the roles. If the roles are not split, a company must disclose whether it has a lead director—and the role played by the lead director.[3]

Notably, the decision to combine or split the roles is often situational, and the board may change its views in response to changing circumstances. For example, the board may split the roles in response to a crisis or when hiring a new CEO, and may combine the roles after a new CEO has proven him or herself and made the case for having both roles. Many companies have corporate governance guidelines that are flexible on the issue, stating that the board has not adopted a formal policy on splitting or combining the roles.

While splitting the roles has become more common, having different individuals serve as CEO and chair does not automatically mean having an independent chair. For example, when a company appoints a new CEO, the outgoing CEO may serve as nonexecutive chair for an interim period to facilitate the transition. According to the *2017 Spencer Stuart U.S. Board Index*, 51 percent of the companies in the S&P 500 split the roles—marking the first time that a majority of the constituents did so—but only 28 percent had an independent chair. In 2007, the comparable percentages were 35 percent and 13 percent. An analysis of S&P 1500 companies by proxy advisor Institutional Shareholder Services (ISS) found that small- and mid-cap companies split the roles more frequently than their large-cap counterparts.[4]

In 2017, 89 percent of S&P 1500 companies had some form of independent board leadership, up from 67 percent in 2008. Breaking these numbers down, 35 percent had an independent chair in 2017 compared to 20 percent in 2008, while 54 percent had a lead director in 2017, compared to 47 percent in 2008. Thus, the overall trends favor more independent leadership, but most frequently in the form of a lead director.

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[1] Sullivan & Cromwell LLP, *2018 Proxy Season Review*, July 12, 2018.

[2] David F. Larcker and Brian Tayan, *Chairman and CEO, The Controversy Over Board Leadership Structure,* Stanford Closer Look Series, June 24, 2016.

[3] Item 407(h) of Regulation S-K.

[4] Institutional Shareholder Services, Inc., *U.S. Board Study: Board Accountability Practices Review,* April 17, 2018.

While the independent chair and lead director roles are both typically held by seasoned independent directors with stature, there are differences between the two. Unlike the lead director, the chair typically has the power under the company's organizational documents to call a meeting of the board and preside at board and shareholder meetings, while also having the practical power to control the agenda and information flow for board meetings. The lead director typically presides at meetings of the independent directors and, as the representative of the independent directors, works with the chair to set the board agenda and determine what information is provided to the board. The role of lead director is evolving, and some companies have added responsibilities such as being available to engage with major shareholders and participating in the board's self-evaluation.

Institutional investors and proxy advisors continue to rely on the description in a company's proxy statement and corporate governance guidelines of its lead director role to determine if it satisfies their baseline for independent board leadership. In that regard, in its *2017 Stewardship Report*, State Street Global Advisors noted that "the most significant improvement has been companies strengthening the lead independent director role by expressly identifying involvement in strategy as a responsibility of the job description." Accordingly, boards should continue to review the role played by their lead director and update the role and its description as appropriate.

About the KPMG Board Leadership Center

The KPMG Board Leadership Center champions outstanding governance to help drive long-term corporate value and enhance investor confidence. Through an array of programs and perspectives—including KPMG's Audit Committee Institute, the WomenCorporateDirectors Foundation, and more—the Center engages with directors and business leaders to help articulate their challenges and promote continuous improvement of public- and private-company governance. Drawing on insights from KPMG professionals and governance experts worldwide, the Center delivers practical thought leadership—on risk and strategy, talent and technology, globalization and compliance, financial reporting and audit quality, and more—all through a board lens. Learn more at kpmg.com/us/blc.

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