The Separation of Chair and CEO Roles: Evolution and Challenges

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Whether separate unrelated individuals must occupy the positions of chair and chief executive officer (CEO) of a company is one of the key unresolved issues in the corporate governance discourse. At the same time, regulators around the world are nudging companies to effect a separation of the roles. The Securities and Exchange Board of India (SEBI) has taken some of the strongest regulatory steps in this direction, whose implementation is currently work in progress.

The Merits and Demerits of Separation

The separation of the chair and CEO roles becomes necessary to ensure that excessive power does not reside in one individual. This also helps demarcate matters pertaining the functioning of the board of directors (which the chairperson oversees) from those relating to the management of the company' business (which the CEO spearheads). However, such a separation suffers from risks as well. For instance, there could be inefficiencies resulting from the duplication of roles. Chairpersons could suffer from informational disadvantages, which could impair decision-making. Curiously, the evidence regarding the merits of separation is highly equivocal, at best. One study finds "little research support for requiring a separation of these roles" and that "the independence status of the chairman is not a material indicator of firm performance or governance quality".[1] Another notes that the benefits of separation are "not so clear cut".[2]

Nonetheless, regulators in leading jurisdictions such as the United States (US) and the United Kingdom (UK) have been calling upon their companies to adopt a separation. While separation is quite the norm in the UK, just over 50 percent of the leading companies in the US maintain separate chair and CEO roles.[3] Even in such cases, recognizing the hazards of a "one size fits all" approach, the regulators only encourage (but do not mandate) companies to adopt separation. This is acknowledgement of the fact that companies may vary in their need for either fusion or separation of the roles. Even more, within the same company the circumstances may vary across different time horizons. For example, Microsoft split the two positions when Bill Gates stepped down as CEO in 2000 to take up chair, but merged them again this year when the current CEO Satya Nadella took on additional charge as chairman.[4]

Regulatory Developments in India

Although recognized, the separated roles of chair and CEO was never high on the agenda in the initial years of the corporate governance movement in India. However, it received legislative mention when the Companies Act, 2013 was enacted. Section 203 provides that the same individual cannot occupy the positions of chair and CEO, unless the articles of association of the company provide otherwise. Hence, through an opt-out mechanism, the shareholders of the company could ultimately determine whether separation is necessary or not. Moreover, the separation requirement does not apply to companies with a single line of business, where it may be considered rather excessive.

The separation requirement received a boost in 2017 when the SEBI-appointed Kotak Committee on Corporate Governance recommended that it be mandatory in two phases: first, for companies with more than 40% public shareholding from April 1, 2020, and for all entities from April 1, 2022. This had the effect of transitioning the separation of chair and CEO from a default mechanism to a regulatory mandate. Taking a cue from the Kotak Committee's recommendation, in 2018 SEBI incorporated such a mandate into the SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 ("LODR Regulations") for the top 500 listed entities on the basis of market capitalisation, although it made some material deviations from what the Committee suggested.

Regulation 17(1B) of the LODR Regulations provides that the chairperson of a company's board shall be a non-executive director, thereby signaling a distinction with the leadership over management of the company. More importantly, SEBI went beyond the Kotak Committee to stipulate that the chairperson shall not be related to the CEO of the company.[5] This requirement is entirely understandable. Historically, there is at least anecdotal evidence to suggest that chairpersonship of a company is part of succession planning, especially in family-owned companies. The generation of entrepreneurs who wish to cede management of family-owned companies to the next tends to transition into a non-executive chair position, with a member of the subsequent generation taking on reins over management as CEO. This has the effect of perpetuating control over the board and management within a closely-knit group, thereby undermining the benefits of separation of the chair and CEO roles. In that sense, SEBI's prescription squarely addresses a phenomenon too prevalent in the Indian corporate ecosphere.

Finally, the separation requirement does not apply to dispersed held companies that do not have any identifiable promoter. Such an exception is somewhat curious. Not only is there a lack of any justification to relieve companies with dispersed shareholding from complying with separation of chair and CEO roles, but it is precisely in the context of such shareholding patterns common in jurisdictions such as the US and the UK that this requirement arose.

Challenges in Implementation

Even though the separation of chair and CEO find place in the Companies Act and the LODR Regulations, there could be several roadblocks in translating the regulatory intention into corporate reality. *First*, the mandate has already encountered vocal resistance from Indian industry. For example, some noted industrialists lament that India's family business-oriented system is vastly different from that in other jurisdictions, and that "Western concepts should not be imported blindly".[6] This is on the ground that the separation occurred in the dispersed shareholding context to impose checks on managers holding small amounts of shares who could wield significant influence by holding dual positions of chair and CEO.

Second, such resistance compelled SEBI to delay the implementation of the separation rule. Originally, regulation 17(1B) of the LODR Regulations was to come into force from April 1, 2020, but SEBI had to enter into a compromise of sorts to delay the implementation to April 1, 2022. Such an uneasy truce would mean that companies have only bided further time to fall in line, but cannot wish away the separation requirement altogether. In fact, SEBI's chairman has hinted that the new deadline is cast in stone and no further extensions will be permitted.

Third, the progress in the run up towards the implementation of the rule next year is somewhat tardy. As of December 2020, only 53 percent of the top 500 listed companies by market capitalization had already separated the roles. Nearly half the companies subject to this mandate will likely scramble to reorganise their top leadership positions in a matter of mere months before the deadline. Going by past experience, there is also a possibility of non-compliant firms, and it would be necessary to await the nature of enforcement actions SEBI might initiate against the laggards.

Fourth, in jurisdictions such as the US and the UK, as well as under the Companies Act in India, the separation is only a default rule, which is ultimately left to the option of the companies. However, the LODR Regulations make the separation of the role mandatory. Given the lack of convincing evidence of the benefits of separation and also the resistance displayed by Indian industry thus far, it remains to be seen whether compliance would be merely in form or even in substance. There is also some merit in introducing a mandate only in companies which bear more significant governance risks, than to all large companies based on market capitalisation.

In all, the separation of the roles of chair and CEO is on the way to becoming reality in Indian corporate governance. However, the extent of its impact on governance as well as corporate performance is anybody's guess.

1. David F.Larcker & Brian Tayan, "Chairman and CEO: The Controversy over Board Leadership Structure", *Rock Centre for Corporate Governance* (June 24, 2016).
2. Marc Goergen, "CEO Duality: For Better and for Worse", *IE Insights* (April 27, 2021).
3. Leslie Josephs, "It's not just Boeing. More companies are splitting CEO and chairman roles", *CNBC* (November 5, 2019).
4. Sean Hollister, "Microsoft CEO Satya Nadella now doubles as the company's chairman", *The Verge* (June 16, 2021).
5. This is based on the definition of "relative" under the Companies Act, 2013.
6. P.Vaidyanathan Iyer, "India Inc opposes Sebi directive on separating owner from management", *The Indian Express* (November 4, 2019).
7. Samie Modak, "India Inc must separate CMD post, deadline won't be extended: Sebi", *Business Standard* (April 6, 2021).