Does CEO Duality Really Affect Corporate Performance?

Raluca-Georgiana MOSCU
Ph D Student, Dimitrie Cantemir Christian University, Faculty of Finance
Email: moscu.raluca@yahoo.com

Abstract

Does CEO duality – the practice of one person serving both as a firm’s CEO and board chair – contribute to or inhibit firm performance? Agency theory suggests that CEO duality is bad for performance because it compromises the monitoring and control of the CEO. Using data of listed Romanian firms from the Bucharest Stock Exchange we analyze the relationship between CEO duality and performance (ROA or ROE). Empirical findings indicate that CEO duality is positively/negatively related to performance.

Keywords: CEO duality, agency theory, stewardship theory, firm performance

1. Introduction

In the last years many firms converted from dual CEO leadership structure to nondual structure, while a much smaller number of firms converted in the opposite direction. This recent trend is partly due to several high-profile cases where powerful dual CEOs were found to abuse their tremendous power, affecting expenses of the company and shareholders. However, empirical evidence is scant and inconclusive on whether non-dual, as versus dual, CEO leadership structure is associated with better firm performance.

Theoretical studies provide no consensus as to whether firms with split titles (CEO and Chairman of the Board) outperform firms with combined titles. Fama and Jensen (1983) and Jensen (1976) suggest that CEO duality may hinder board’s ability to monitor management and thereby increase the agency cost. As a result, splitting the titles of CEO and Chairman of the Board will improve firm performance.

A first objective of the research is constituted by the determination of shareholding’s structure and implicative of the companies managed by a CEO - Chairman or not, for companies listed in Bucharest Stock Exchange, overall and on activity sectors. The second objective of this study is to examine the relationship between CEO duality and the company’s performance. Therefore linkages between performance of the listed companies and several key features will be tested, that are of interest in this study related to CEO duality, Chairman of the Board of Directors, ownership's structure, management - shareholder in the company, institutional investors - shareholders, company size and debt-to-equity ratio or the relationship between CEO duality - Chairman of Board of Directors and shareholder’s structure.
The work is structured as it follows: Section 2 presents the main theoretical foundation, in Section 3 it is described the variables used and the work methodology, and Section 4 contains the results of empirical testing. The last part is dedicated to conclusions.

2. Theoretical Foundation and Literature Review

An important issue discussed in the literature which we have allocated a necessary space, because the duality practice is quite common in Romania is the separation of general manager position of the Chairman of the Board of Directors. This recommendation was made by the Cadbury Report in 1992 in the UK and also other reports: Dutch Peters Committee Code in 1996 and the Belgian Commission of Banking and Finance Code in 1998. In Romania it is not recommended the pluralism of functions, the term "recommended" not being strictly kept, there may be cases in which the President assumes responsibility for the overall management of the company.

Jensen has identified for the American Finance Association the potential tasks of the Chairman arguing that "The Chairman position is that to run board meetings and to oversee the hiring, firing, evaluation and compensation process of the CEO" (Felton, R., 2004). Consequently, for a board to be effective it is important to separate the positions of CEO and Chairman. So one of the key purposes for corporate governance is to find roles of the two functions, different roles but complementary.

**Table 1 The roles of CEO and Chairman of the Board of Directors**

<table>
<thead>
<tr>
<th>Chairman of the Board of Directors</th>
<th>General Manager</th>
</tr>
</thead>
<tbody>
<tr>
<td>He ensures implementation of the company's strategy by the Board of Directors.</td>
<td>Responsibility: the company's performance, as it is requested by the Board of Directors strategy.</td>
</tr>
<tr>
<td>He plans the Boards meetings and he ensures that the last one receives the adequate information.</td>
<td>He ensures that the Board of Directors understands all the aspects of operational activity.</td>
</tr>
<tr>
<td>He manages the Board discussions to a certain point of interest.</td>
<td>He keeps a permanent dialog with the Chairman of the company.</td>
</tr>
<tr>
<td>He determinates the composition of Board of Directors.</td>
<td>Makes the team of executive managers.</td>
</tr>
<tr>
<td>He operates so that the company is managed representative: explains the purposes of actions unfolded, company's policy for the insiders, but especially for those outside the company.</td>
<td>He's in charge of the operational plan, financial and control system for the enterprise. Closely monitors the operational activity, financial results in accordance with plans and budget.</td>
</tr>
<tr>
<td>He ensures the company's and the Board's management</td>
<td>He represents the company in customer relationship and professional associations.</td>
</tr>
</tbody>
</table>
Duality represents a problem because people that are responsible for the firm's performance are the same with those who evaluates the efficiency. This situation makes difficult the correct evaluation of the firm's performance and may conduct to an under-performance of the company on long term; such an arrangement concentrates too much power in the hands of one executive and may lead to low performance. As qualified as the manager - Chairman would be - we talk about many responsibilities that fall to his subject, which can lead to inefficiency if one or both positions are held. In terms of CEO - Chairman of the Board of Directors duality the professional theory comes with two different approaches, showing that in terms of agent theory duality negatively affects the corporate performance and the stewardship theory says the opposite.

For instance, in one hand, agency theory, which advocates that separation of the CEO-Chairman positions would maximize corporate performance since the board has an unbiased authority to oversee the CEO’s functions (Gillan, S.L., 2006; Harris, D., Helfat, C.E., 1998; Shleifer, A., Vishny, W., 1997). Dahya, J., Travlos, N., (2000) document a positive association between CEO duality and firm performance. Dahya, J., (2005) show that splitting the titles of CEO and Chair of the Board among U.K companies is not associated with performance improvement. However, the empirical evidence is mixed and inconclusive. Pi, L., Timme, A., (1993) find that there is negative relationship between CEO duality and accounting performance measures in banking industry. Pi, L., Timme, A., (1993) find that in the banking industry, over the 1987-1990 period, non-duality firms outperformed duality firms. Because CEO duality signals the absence of separation of decision management and control (Fama, F., Jensen, M., 1983), the board will be unable to effectively monitor and evaluate the CEO. This one is more likely to use his power as board chair to select directors who are not likely to challenge CEO actions. For corporate governance mechanisms, dual CEO firms have larger board size, suggesting that dual CEO firms have poorer governance and more inefficient board.

H$_1$: CEO duality is negatively associated with firm performance.

Contrary to agency theory, stewardship theory outlines that holding both positions by one person would enhance firm performance with that holding two positions by one person can monitor the firm unambiguously and can have a unique command throughout the firm (Adams, R., Almeida, H., Ferreira, D., 2005; Davis, JH, Schoorman, D, Donaldson, L, 1997; Finkelstein, S, D'Aveni, RA., 1994). Dual-CEO firms also have higher institutional ownership and financial leverage, indicating more external monitoring, which also might be required to reduce agency problem. Stewardship theory maintains that CEO duality creates a unity at the top of the organization (Donaldson and Davis, 1991). Interestingly is the fact that dual CEO firms also have higher CEO ownership, which might be required to more strongly align the interests of CEO and shareholders. CEO duality, therefore, helps to avoid confusion among managers, employees and other stakeholders as to who is the boss and facilitates more timely and more effective decision-making (Finkelstein, S, D'Aveni, RA., 1994). Otherwise, the firm may experience conflicts at the top, reduced speed and effectiveness indecision-making and, finally, poor performance (Brickley, J., et al., 1997; Donaldson, L., Davis, J., 1991). Chaganti, R., Mahajan, V.,
Sharma, S., (1985) compared 21 bankrupt firms with 21 surviving firms in the retailing industry, find no differences as a function of CEO duality. Faleyé (2007) find that CEO duality is positively related to organizational complexity, CEO reputation and managerial ownership.

\[ H_2: \text{CEO duality is positively associated with firm performance.} \]

Rechner, P. L., Dalton, D. R., (1999) examine the performance between firms with dual and non-dual CEOs over the period 1978 to 1983. They use return on assets (ROA), return on equity (ROE) as their measures of performance in trying to distinguish between duality and non-duality firms. They find results that are not entirely consistent, and report that in periods with high financial returns (1978-1980) the non-duality firms out-performed the duality firms. The difference in performance was less significant in 1981-1983 when returns were more modest. Baliga, B., Moyer, R., Rao, R., (1996), found no evidence of performance changes surrounding changes in the duality status. Daily, C., Dalton, D., (1997) find that there is no significant difference in performance between dual CEO and non-dual CEO firms.

3. Data Base And Research Methodology

To test the validity of the assumptions stated above for the practice of listed companies it was compiled a sample of 62 companies listed on the Bucharest Stock Exchange, Class I and II. Necessary financial information was gathered from several sources: website BSE, site Investment Consulting Company KTD Invest SA and the Company’s website Financial Investment Services Intercapital Invest SA.

The analysis is based on identifying the relation between CEO-duality and performance or between CEO-duality and ownership. To perform empirical analysis it is used multiple linear regression and basic statistical tests. The empirical analysis is used to test the relationship between the dependent variable ROA (return on assets) or ROE (return on equity) and independent variables.

The dependent variable is the ROA (return on assets) or ROE (return on equity) variable which measures performance. From the available data we can construct a vector of repressors Xi (DUAL, MAN, INST, OWN, SIZE, D / E), which allegedly can influence the outcome Y result. Specifically, we assume that the model takes the form:

\[ Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \cdots + \beta_k X_k + \varepsilon \]

where \( k = 1,2,\ldots,62 \) (number of companies listed in Bucharest Stock Exchange), \( Y \) - dependent variable which measures firms performance and noted with ROA (return on assets) or ROE (return on equity), \( X_k \) - independent variables.

To test the relationship between variable that indicates the existence of a duality CEO Chairman of the Board of Directors and shareholder structure is necessary to use a probity model. The designs used were type probity, non-linear models, which are used where the dependent variable is binary:
\[ \Pr(Y = 1/X) = \Pr(Y = 1/X_1, X_2, \ldots, X_n), \text{ where } \Pr \text{ denotes probability} \]

\[ Y^* = \alpha + \sum X\beta + \epsilon, \text{ where, } \]

\[
Y = \begin{cases} 
1 & \text{if } Y^* > 0 \\
0 & \text{otherwise}
\end{cases}
\]

Definitions of the dependent and independent variables are:

- **ROA** - the dependent variable which measures return on assets;
- **ROE** - the dependent variable which measures the return on equity;
- **DUALITY**: CEO and the Chairman of the Board of Directors of a firm are the same person (these functions are held by a single person). If the CEO of the company is the same with the Chairman, the dummy variable takes the value 1 and 0 if not;
- **INST** - Institutional ownership concentration (The percentage owned of the company's shares);
- **MAN** - CEO as shareholder (The percentage owned of the company's shares);
- **OWN** - A dummy variable that takes the value 1 in the case of companies with concentrated shareholding (the first three shareholders own more than 50% of the shares of listed companies) and 0 in the case of companies with dispersed shareholding;
- **SIZE** - The size of the company is measured as being a logarithm of stock capitalization;
- **D/E** – Debt-to–Equity ratio is the proportion between Total Debt / Total shareholder's equity.

4. **Empirical Results**

Descriptive statistics: Descriptive statistics for the main variables are presented in Table 2. Statistics show two important remarks: in average the duality represents 38% for listed companies and it is observed that 77% of companies listed on the Bucharest Stock Exchange have concentrated ownership. Skewness and kurtosis values show that the distribution of variable DUAL is platokurtica (kurtosis< 3) and asymmetric (Skewness>0).
Table 2 Descriptive statistics

<table>
<thead>
<tr>
<th></th>
<th>DUAL</th>
<th>MAN</th>
<th>INST</th>
<th>OWN</th>
<th>SIZE</th>
<th>D/E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>0.3871</td>
<td>0.0789</td>
<td>0.5059</td>
<td>0.7742</td>
<td>18.0450</td>
<td>0.4118</td>
</tr>
<tr>
<td>Median</td>
<td>0.0000</td>
<td>0.0000</td>
<td>0.5575</td>
<td>1.0000</td>
<td>17.8151</td>
<td>0.3013</td>
</tr>
<tr>
<td>Maximum</td>
<td>1.0000</td>
<td>0.7230</td>
<td>0.9993</td>
<td>1.0000</td>
<td>23.5561</td>
<td>1.7000</td>
</tr>
<tr>
<td>Minimum</td>
<td>0.0000</td>
<td>0.0000</td>
<td>0.0000</td>
<td>0.0000</td>
<td>12.8919</td>
<td>0.0126</td>
</tr>
<tr>
<td>Std. Dev.</td>
<td>0.4911</td>
<td>0.1859</td>
<td>0.3151</td>
<td>0.4215</td>
<td>1.9928</td>
<td>0.3545</td>
</tr>
<tr>
<td>Skewness</td>
<td>0.4636</td>
<td>2.2202</td>
<td>-0.3091</td>
<td>-1.3116</td>
<td>0.3578</td>
<td>1.1979</td>
</tr>
<tr>
<td>Kurtosis</td>
<td>1.2149</td>
<td>6.5780</td>
<td>1.8580</td>
<td>2.7202</td>
<td>3.4666</td>
<td>4.3474</td>
</tr>
</tbody>
</table>

Correlation Matrix: Table 3 shows the correlation matrix of the variables included in the model. Duality variable (DUAL) is negatively correlated with variables OWN (majority ownership structure), MAN (management as a shareholder), D/E (debt-to-equity ratio) and variable INST (showing percentage held by institutional investors in the company). The correlation matrix does not indicate a multi-collinearity (that some variables are highly correlated). For this reason, we will present three models in the next section, in order to examine the relationship between independent variables and CEO–duality.

Table 3 Variables correlation matrix

<table>
<thead>
<tr>
<th></th>
<th>DUAL</th>
<th>MAN</th>
<th>INST</th>
<th>OWN</th>
<th>SIZE</th>
<th>D/E</th>
</tr>
</thead>
<tbody>
<tr>
<td>DUAL</td>
<td>1.000</td>
<td>-0.019</td>
<td>-0.281</td>
<td>-0.363</td>
<td>0.046</td>
<td>-0.170</td>
</tr>
<tr>
<td>MAN</td>
<td>-0.019</td>
<td>1.000</td>
<td>-0.485</td>
<td>-0.093</td>
<td>-0.220</td>
<td>0.014</td>
</tr>
<tr>
<td>INST</td>
<td>-0.281</td>
<td>-0.485</td>
<td>1.000</td>
<td>0.582</td>
<td>-0.089</td>
<td>0.047</td>
</tr>
<tr>
<td>OWN</td>
<td>-0.363</td>
<td>-0.093</td>
<td>0.582</td>
<td>1.000</td>
<td>0.104</td>
<td>0.006</td>
</tr>
<tr>
<td>SIZE</td>
<td>0.046</td>
<td>-0.220</td>
<td>-0.089</td>
<td>0.104</td>
<td>1.000</td>
<td>-0.016</td>
</tr>
<tr>
<td>D/E</td>
<td>-0.170</td>
<td>0.014</td>
<td>0.047</td>
<td>0.006</td>
<td>-0.016</td>
<td>1.000</td>
</tr>
</tbody>
</table>

Capital market in Romania is usually characterized by companies with high levels of ownership concentration, so that decisions are taken by few shareholders. Therefore, we talk about a developing market characterized by family, state, or foreign investor-owned enterprises. The first conclusion that we can draw is that the Romanian firms have concentrated ownership structure (see Table 4). It is noted that a number of 48 out of 62 companies listed on the BSE have a concentrated ownership, representing over 77% of the sample (see Table 4). It is also noted that 24 of the 62 listed companies practice CEO-Chairman of the Board of Directors duality.
The biggest problem is that these general managers, who have an equity stake are also Chairman of companies or they are relatives of first degree with the company's Chairman. There are situations where general manager, shareholders, is the same as the Chairman of Board, so besides the fact that there is no separation between executive function and the Chairman one, it appears that the same person owns a large percentage of company shares, shares that provide a significant voting. Of the 62 companies listed on BSE only 5 have as shareholding the general manager of the company (the same with the Chairman of the Board).

In Romania it is not recommended the pluralism of functions, the term "recommended" not being strictly observed, there may be cases in which the Chairman assumes responsibility for the overall management of the company. When talking about the same person, a plurality of functions, the general manager becomes the head of the Board and in this situation it will be difficult for other members of the board not to have any control over the actions of the manager - Chairman. And yet many companies practice this pluralism of functions or because of tradition or they don't feel the need for a change because the company is performing. In the case of BSE there are 24 companies (38.7% as a percentage) that do not comply with governance codes relating to pluralism of functions of general manager - Chairman of the company.
In the following regression model it is desired the evaluation of the relationship between variable ROA (Return on Assets) or ROE (return on equity) and explanatory variables), DUAL (dummy variable that takes value 1 if the manager is also Chairman of the Board, 0 if the functions don't overlap), MAN (percentage of shares held by the general manager), INST (percentage of shares held by institutional investors) OWN (dummy variable that takes value 1 if ownership is concentrated (the top three shareholders own cumulated more than 50% of the company's shares and 0 if it is dispersed) SIZE (company size) and D / E (debt-to-equity).

**Table 5 Regression models and results**

<table>
<thead>
<tr>
<th>Dependent Variable</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ROA OLS model</td>
<td>ROE OLS model</td>
<td>DUAL Binary model</td>
</tr>
<tr>
<td>Independent Variable</td>
<td>Coefficient</td>
<td>Probability</td>
<td>Coefficient</td>
</tr>
<tr>
<td>DUAL</td>
<td>0.0513</td>
<td>0.343</td>
<td>-0.0742</td>
</tr>
<tr>
<td>MAN</td>
<td>-0.1462</td>
<td>0.380</td>
<td>-0.4079</td>
</tr>
<tr>
<td>INST</td>
<td>-0.1183</td>
<td>0.324</td>
<td>-0.2616</td>
</tr>
<tr>
<td>OWN</td>
<td>0.0143</td>
<td>0.854</td>
<td>-0.0465</td>
</tr>
<tr>
<td>SIZE</td>
<td>0.0061</td>
<td>0.646</td>
<td>0.0004</td>
</tr>
<tr>
<td>D/E</td>
<td>0.0528</td>
<td>0.444</td>
<td>-0.2148</td>
</tr>
<tr>
<td>R²</td>
<td>7.51</td>
<td>8.21</td>
<td></td>
</tr>
<tr>
<td>Probability</td>
<td>0.61</td>
<td>0.55</td>
<td>0.03</td>
</tr>
</tbody>
</table>

For the first model that we used as variation the explanatory ball economic profitability, all assumptions are responded and coefficients are not significant (see Table 5). This means that there is no significant relationship between these variables: on the one hand, ownership concentration, management as ownership and CEO - President duality and on the other hand the company's performance (ROA).

The main objective of this paper is to explore the relationship between CEO - Chairman duality and the firm's performance (ROA), on a sample of Romanian companies listed on Bucharest Stock Exchange. Empirical results show that firms listed show that duality would lead to a high performance, regression coefficient sign is positive, but not significant (p-value is high). It is noted that the relationship between the two variables duality (DUAL) and the corporate performance (ROA) is a positive one, but insignificant.

The results of the regression Model 3 (Table 5) show that it is possible that the duality of companies in Romania to be adversely affected by the existence of a majority ownership (OWN). If we consider that 77% of companies listed on Bucharest have a concentrated ownership structure, these companies prefer same person CEO or Chief of the Board.
The relationship between the variable that shows the duality within the company (DUAL) and concentrated structure of ownership (OWN) is significant. One possible explanation could result from the fact that these companies that have a concentrated structure tries to find ways to protect the rights of minority shareholders and to comply with corporate governance principles, giving up the practice of duality function (general manager and the chairman of the shareholders).

5. Conclusion

When talking about the same person, about a plurality of functions, undertaken activities do not require much explanation. So the general manager becomes the head of the board and it will be difficult for other members of the board not to have any control over the actions of the manager - President. And yet many companies practice this pluralism of functions either because of tradition or they don't feel the need to change because the company is performing. But suppose that the principles of corporate governance will improve, they will create mandatory existence of different people for the two functions, and former CEO - Presidents will keep the managing position of the Board, a question still remains "How much involvement of the Chairman is allowed?"

In the mid 90s in the UK, the company’s board has separated on the recommendation of the Code of Good Practice - Cadbury Code, and some presidents - general managers have dropped from the second position in favor of the former. Companies that have done so have found that it was not profitable, as the new CEO came in has instituted changes encountering non-collaboration of the Chairman. Similar problems can occur if the president was dropped in favor of CEO, because the current board of directors will continue to see the CEO, as the leader of the company or even the general manager do not accept orders from the new president. So the problem of separating the roles of CEO and Chairman of the Board still seems one final unresolved.

With a sample of 62 companies listed on the Bucharest Stock Exchange we have tried to analyze the relationship that is established between CEO - Chairman of the Board of Directors duality and company’s performance (ROA) or financial performance (ROE). Both regression models have identified a positive or negative relationship between the two variables because the regression coefficients are not significant. A third model tested the relationship between duality within company and ownership structure. Note that a concentrated structure adversely affects the duality CEO - Chairman of the Board of Directors.

A real problem could be the existence of managers who hold shares within listed companies, which in addition of executive function they own the position of Chairman of the Board of Directors. With the help of empirical testing it is demonstrated that the performance is negatively influenced if the manager - President holds equities, which indicates that the respective person is more interested in maximizing personal wealth at the expense of shareholders wealth maximization.
Both theoretical and empirical studies are inconclusive as to which might be better: CEO and Chair of the Board positions into one person or splitting the titles. In our country, regulators and investors have become more and more strongly recommending separation of CEO and chairman duties. Our findings don’t provide clear answers to research question that raise in the beginning of the paper.

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