

**January 2015**

**Combination or separation of the offices of  
Chairman of the Board and Chief Executive  
Officer**

**Choice of governance formula**



French law gives all limited companies, including listed corporations, the choice between a unitary formula with a Board of Directors and a two-tier structure with a Management Board and a Supervisory Board based on a distinction between management functions and the supervision of this management<sup>1</sup>. Moreover, companies with a Board of Directors have a choice between separating and combining the offices of Chairman and Chief Executive Officer.

According to Article L.225-51-1 subparagraphs 1 and 2 of the Commercial Code, which favours neither formula: *“The executive management of the company shall be assumed under their responsibility by either the Chairman of the Board of Directors or by another natural person appointed by the Board of Directors and bearing the title of Chief Executive Officer. In accordance with the conditions defined by its articles of association, the Board of Directors shall choose between the two forms of performance of the executive management referred to in subparagraph one. The shareholders and third parties shall be informed of this choice in accordance with the conditions laid down by Conseil d’Etat decree”*.

Nor does the AFEP-MEDEF Code<sup>2</sup> favour one particular formula. It specifies that *“it is up to each corporation to decide on the basis of its own specific constraints”* and that when a corporation opts for separation of the offices of Chairman and Chief Executive Officer, *“the tasks entrusted to the Chairman of the Board of Directors in addition to those conferred upon him or her by law must be described”*.

It is therefore up to the Board of Directors to choose whether to separate or combine the offices of Chairman and Chief Executive Officer. This is a key prerogative of the Board of Directors which must, according to the code, report the grounds and justifications for its decision to the shareholders.

The choice of mode of governance must first take into account the specific characteristics of the company **(1)**. The fact that major differences exist between French law and British law must then be underlined **(2)**. Finally, other avenues may be explored for achieving the same balance of powers objective **(3)**.

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<sup>1</sup> The use of the two-tier formula is decreasing. Statistics show that the number of companies adopting the Management Board and Supervisory Board is down, and that several of these have returned to the conventional system of having a Board of Directors.

<sup>2</sup> § 3.1 of the AFEP-MEDEF Code.

## 1. THE BOARD OF DIRECTORS MUST BE ABLE TO DECIDE IN THE BEST INTERESTS OF THE COMPANY ACCORDING TO ITS SPECIFIC CHARACTERISTICS

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A corporation's choice of mode of governance must take its specific characteristics into account, particularly its business sector, shareholder composition and even the characteristics of its executive management team (membership, experience of being in office, etc.)<sup>3</sup>.

Some companies have chosen to separate the offices of Chairman of the Board of Directors and Chief Executive Officer, and this has proven to be particularly relevant by enabling the Chairman to focus on the tasks specific to his or her position (e.g. Alcatel, BNP Paribas, Sanofi).

Conversely, in order to promote decision-making speed and efficiency and improve the cohesion of the corporate organisation, other companies have opted to combine the offices of Chairman and Chief Executive Officer. Incidentally, many companies have moved from one formula to another during their existence. Indeed, some companies have returned to a mode of organisation with a unified Chairman/Chief Executive Officer (CEO) after having used the split formula, particularly as a way of ensuring the transition of power between one unified Chairman/CEO and his or her successor (e.g. Cap Gemini in 2012, L'Oréal in 2011, Axa, Orange, Saint-Gobain, Veolia, Vinci and Total in 2010, Société Générale, Accor and Renault in 2009), showing that the structure with a unified Chairman/CEO has advantages in terms of responsiveness and simplifying decision-making processes, particularly during periods of crisis.

A Conference Board<sup>4</sup> paper reviewing the main academic research on the subject concludes that no governance formula is superior to another and that it depends primarily on the personality of the Chairman: *"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".*

With regard to US companies, a 2011 study involving 100 of the largest listed companies<sup>5</sup> shows that the offices of "Chairman" and "CEO" are combined in 73 companies. Furthermore, it states that 79 companies did not define a policy, considering that it is up to the Board to decide the most appropriate form of governance for the company, 10 companies defined a policy in favour of separating the offices, nine companies defined a policy in favour of combining the offices and two companies did not give any indication.

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<sup>3</sup> For the financial year 2013, within CAC 40 companies with a Board of Directors, CEOs make up the vast majority (26 CEOs compared to five separate MDs/Chairmen). The same is true for SBF 120 companies (63 CEOs compared to 22 separate MDs/Chairmen).

Furthermore, four CAC 40 companies and 17 SBF 120 companies opted for the formula with a Management Board and a Supervisory Board.

<sup>4</sup> The Conference Board's Director Note, Separation of Chair and CEO Roles August 2011. [http://www.yorku.ca/rleblanc/publish/Aug2011\\_Leblanc\\_TCB.pdf](http://www.yorku.ca/rleblanc/publish/Aug2011_Leblanc_TCB.pdf)

<sup>5</sup> Cf. study by Shearman & Sterling: "Corporate Governance of the Largest US Public Companies 2011".

Another Conference Board<sup>6</sup> report concerning companies in the S&P 500 index shows that, in 2011, approximately 60% of companies maintained a governance formula combining the offices, while 40% opted for separating the offices. It seems that some companies (e.g. Boeing) prefer to put in place a “Lead Director”, like in the United Kingdom.

The Board should therefore be given every latitude to organise its mode of operation in the best interests and according to the specific characteristics of the company.

## 2. DIFFERENT LEGAL AND GOVERNANCE CONTEXTS UNDER FRENCH LAW AND BRITISH LAW

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The desire to impose the separation of the offices of Chairman and Chief Executive Officer fails to recognise the differences between corporate law in France and in the United Kingdom.

In fact, as far as the supporters of separation of powers are concerned, the role of the “separate” Chairman is fundamental in that it constitutes a counter-force with regard to the executive management. While appealing in principle, this position largely ignores (by overestimating them) the respective powers of the Board of Directors, which is a collegial body, and those of the Chairman of the Board of Directors under French law.

- **In France**, the Board and the executive management have different tasks: indeed, according to the Commercial Code, the Board’s task is to decide the broad guidelines and strategy of the company. The executive management, which is generally assisted by an executive committee whose membership is strictly different from that of the Board of Directors, is responsible for the day-to-day management of the company. No company can bring together these tasks within an executive body without significant risks as regards responsibility and the risks of certain decisions being void. **Furthermore, the Commercial Code prohibits the number of directors bound to the company through a contract of employment exceeding one third of the Board’s members<sup>7</sup>. Moreover, Boards are almost exclusively made up of non-executive directors (unlike in the United Kingdom).**

As a result of the significant powers conferred on it by law, the Board of Directors in its entirety must guarantee the balance that is essential for good governance. Consequently:

- any decision by the Board of Directors must be voted for by a majority of the Board’s members, meaning that the executive directors represented on the Board cannot carry the decision on their own;
- if it has not met for more than two months, at least one third of the directors may ask the unified Chairman/CEO to call a meeting of the Board of Directors regarding the agenda determined by these directors; in the Chairman’s absence, this power is

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<sup>6</sup> “Conference Board’s 2011 Director Compensation & Board Practices Report”.

<sup>7</sup> Art. L. 225-22 of the Commercial Code. When the Board includes directors representing employees, they are not taken into account.

sometimes conferred on another director by the by-laws (often the lead director if there is one);

- the Board of Directors may dismiss the unified Chairman/CEO at any time without having to give grounds;
- it sets the compensation of the unified Chairman/CEO ;
- it may place limits on the powers of the unified Chairman/CEO .

Finally, it has the power to call shareholders' meetings, prepare the company accounts and the annual management report, authorise agreements made between the company and one of its executive officers, directors or shareholders with more than 10% of the voting rights, allocate directors' fees, approve the chairman's report regarding internal control, and so on.

Under French law, the Chairman of the Board of Directors has an essentially administrative and leadership role, i.e. calling Board meetings, setting the agenda, preparing reports, chairing discussions, and so on. **He or she does not have any decision-making authority of his or her own.** He or she only has decision-making authority as a member of the Board, which is a collegial body. Even the report that he or she is responsible for preparing regarding the organisation of the Board's work, internal control and risk management has to be approved by the Board (Article L.225-37 of the Commercial Code). Some companies define the tasks that the Chairman performs outside of the legal provisions in a more explicit manner. For example, these include tasks involving representing the company in its high-level dealings, particularly with key clients and the authorities, both nationally and internationally.

- **In the United Kingdom**, most companies operate under a separation of offices system, as they have adopted the practice of a **“unitary system”<sup>8</sup> which combines both non-executive directors and members of the executive committee** (generally four individuals who are also directors). Given this specific mode of operation, it appeared necessary within British companies to organise counter-force mechanisms. We should point out that the British system, which is frequently presented as a model, has been criticised by academics and business leaders, who are of the opinion that it may lead to conflicts between the “Chairman” and the “CEO” as well as to **an unclear division of responsibilities.**

### 3. THE BALANCE AND EFFECTIVENESS OF GOVERNANCE IS ENSURED BY OTHER MEANS

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In order to ensure balance within the Board, whilst combining the offices of Chairman and Chief Executive Officer, French companies have implemented the following practices:

- the introduction by the Board of Directors of limitations on the powers of the Chief Executive Officer; these rules generally feature in the Boards' internal regulations, which specify those cases where the prior approval of the Board of Directors is required, for

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<sup>8</sup> Cf. Etude Heidrick & Struggle: “Challenging board performance, European corporate governance report 2011”, p.10.

example for planned investments over a certain amount and more generally for certain strategic operations. These limitations are published in the Chairman's report regarding governance and internal control (Art. 4 of the AFEP-MEDEF Code);

- the appointment of a significant proportion of independent directors to the Board (Art. 9.2 of the code);
- the possibility for individuals other than the unified Chairman/CEO (e.g. the deputy chairman, lead director or Board committee chairmen) to call a meeting of the Board of Directors regarding an agenda they have set and which is within the Board's jurisdiction;
- the establishment of specialist committees responsible for preparing the Board's work in the fields of compensation, nominations and auditing (Art. 16 of the code);
- the review of certain matters strictly without the presence of executive members, not just the unified Chairman/CEO but also the CEO where there is separation of offices;
- regular meetings of non-executive directors without the presence of executive or internal directors in order to assess the performance of the executive directors (Art. 10.4 of the code);
- the appointment of a lead independent director who is sometimes called the deputy chairman. The role of this independent director, arising from practice, is to ensure the smooth operation of the governance bodies, particularly through the active involvement of the independent directors in the work of the Board and of its committees. Of the tasks that might be entrusted to this director, two appear to be particularly key, namely the possibility, under certain circumstances, of calling a Board meeting and the possibility of suggesting that the unified Chairman/CEO should place points on the agenda. However, it should be specified that such an appointment in no way alters the collegial nature of the Board of Directors as a body.

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In conclusion, while the balance of powers with the executive management is undoubtedly a legitimate and important issue, the systematic separation of the offices cannot be seen as a one-size-fits-all governance formula, as this would fail to recognise both how companies actually operate and their specific needs. The law and other mechanisms enable the Board of Directors to play a leading role and independently "challenge" the executive management, which helps guarantee the desired balance in an even more effective way.