ЮРИДИЧНІ НАУКИ

DOI: https://doi.org/10.32839/2304-5809/2020-4-80-89
UDC 347.7

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RELATIONSHIP PROBLEMS BETWEEN INDEPENDENT DIRECTORS AND CEOS IN PUBLIC COMPANIES

Summary. This study is an initial attempt to determine what factors can negatively affect the effectiveness of co-operation between Chief Executive Officers (CEOs) and independent direc-tors in publicly held companies with dispersed share ownership. Conventional wisdom holds that independent directors are able to protect the interests of shareholders in cases of shareholder-management agency conflicts through objective monitoring of decisions of top executives. At the same time, the establishment of mutually trusting relationships between CEOs and independent board members that contribute to successful corporate governance can be quite a difficult task, since the interests of these two groups in most cases differ fundamentally. Top managers, particularly CEOs, may use various mechanisms to make it difficult for independent outside directors to fulfill their monitoring responsibilities. Thereby, it is rather obvious that independent directors working in such conditions are unable to represent and protect the interests of shareholders at the appropriate level.

Keywords: CEO, independent directors, board of directors, monitoring, information asym-metry.

Problem statement. It is hard to underestimate the influence of the chief executive officer (CEO) in the company. In the modern corporate hierarchy system, a CEO is the highest-ranking executive who makes primary corporate decisions, manages and distributes the company's resources, controls core business operations, represents the company, etc. (Kenton, 2019). In other words, a CEO must make paramount decisions that ensure the sustainable growth of the company and be the link between the company and the external environment (society, economy, technology, markets, and consumers). Undoubtedly, having such responsibilities, CEOs have tremendous power and influence over the company, including inside directors serving on the board.

If CEOs have such power, the risk that they will take actions aimed at obtaining personal benefits at the expense of shareholders increases. This factor was given even more attention in the early 2000s, after the huge scandals surrounding the fraudulent management activities of large enterprises such as Enron, Tyco, and WorldCom. After these infamous events, a large-scale reform of the composition of the boards of directors of public companies was initiated. At the present time, the presence of independent directors on the board of public companies is generally accepted and widely used practice in the majority of jurisdictions around the globe (OECD, 2019).

An effective corporate governance model currently requires the presence of independent outsiders on the boards of directors of publicly held companies since these board members can withstand the tremendous influence that CEOs wield. For the board of directors, as the body overseeing senior management performance, independence and impartiality are crucial criteria. Therefore, adding independent directors to the board of directors aims to weaken the power of the CEO over the board and to protect the interests of shareholders.

Recent research and publications. The question of the relationship between these parties and the influence of independent directors on the CEO's authority in the company has been raised earlier. After changing the requirements regarding the composition and powers of boards of directors in public corporations, a number of researchers have drawn attention to the consequences of the introduction of independent directors on boards. The analysis of modern scientific publications has demonstrated that some studies suggest that the likelihood of dismissal of the poor performing CEO (Hwang and Kim, 2009; Goyal and Park, 2002), as well as the replacement of the fired CEO with an outsider (Huson et al., 2001) is higher in firms with outsider-dominated boards. At the same time, Bhagat and Bolton (2008) disagree with the view that in all cases the boards with a majority of independent directors significantly diminish the CEO's influence. As the results of all these studies have demonstrated, there are still obstacles complicating the effective implementation of the protection of shareholders' interests by independent board members.

The purpose of the article is to identify factors that counteract and complicate effective and trusting collaboration between independent directors and managers in publicly traded companies. It is important to note that the study covers only publicly held companies with dispersed share ownership i.e. firms with no controlling shareholder, but with a large number of shareholders, each of whom owns only a small fraction of the total number of shares.

The methodological framework of the present research is a comprehensive analysis of the results of fundamental and applied research in the field of corporate governance, the composition of the board of directors and the role of independent directors in it. The current study is based not only on general research methods, such as comparative and qualitative but also on special scientific research methods, including abstract-logical, analysis, and synthesis.

Presentation of the main material. In general, in public firms, the interaction between the CEO and the board of directors boils down to the bargaining game, where these parties try to find compromises on issues concerning company administration, such as director selection or amount of compensation packages (Hermalin and Weisbach, 1998). In the course of this bargaining game, chief executive officers often enjoy various advantages that make independent directors unable to act as protectors of shareholders. For instance, Bebchuk et al. (2002) emphasize that senior managers frequently have enough authority to influence the appointment of new directors. The mere presence of independent directors on the board of directors does not ensure the implementation of a shareholder-minded monitoring system in the company.

Currently, the main factors creating challenges in relations between CEOs and independent directors are the following:

1. Information asymmetry. Unlike insider directors, independent outsiders are not full-time employees of the companies which boards they serve on. Director independence implies an absence of any considerable material relationships with the company that could undermine a bias-free judgment. This independence status is associated with the desire to ensure a balance in corporate governance through strengthening the role of independent boards of directors, providing effective monitoring and advising aimed at protecting shareholders. The absence material bonds with companies, including employment relations, with companies allows independent directors to avoid formal dependence on senior management that is faced almost by all insiders since the career advancement prospects of the latter is highly dependent on top managers. However, such an order creates an information asymmetry since independent directors are not involved in the daily management, and accordingly, they possess extremely scarce information about the affairs of the firm. Effective monitoring requires that independent board members receive comprehensive firm-based information from insiders and C-level executives. Powerful CEOs with access to information and influence over the inside directors may remove independent outsiders from corporate decision-making.

Consequently, independent directors' lack of information about the company's day-to-day running can be used against them. For instance, suppose that we have a situation where the firm's management develops several different projects of the firm's investment line. These projects are characterized by different risk levels and complications of management. Top executives may prefer a certain project for the reason of its low degree of risk and easiness of management in spite of the fact that other projects have a higher level of possible returns. Management decides to introduce only the project that it prefers to the board of directors, instead of presenting all developed investment projects. In this scenario, even the board with a majority of independent outsiders is likely to agree to a project that is beneficial to the managers and not to the shareholders for the simple reason that it is unaware of the existence of alternative options.

2. Appointment of new board members. In addition to information asymmetry, CEOs may reduce board independence in other ways. The ability to influence the appointment of directors to the board greatly strengthens the position of the CEO. As it is noted by Coles et al. (2014), in the majority of cases, monitoring is weakened if independent directors are appointed after taking office by the CEO. Despite the fact that shareholders choose directors to be appointed to the board, in dispersed ownership, shareholders often simply vote for the slate proposed by the board of directors [14, p. 53].Cohen et al. (2012) suggest that this order increases the possibility of appointing candidates who will be overly sympathetic to the top managers. In addition, an important role in such cases is also played by personal acquaintances and social ties [12, pp. 139–141]. Thereby, promoting candidates that are advantageous to them, CEOs intent to create fractions of loyal directors, with the help of which they will receive the necessary support from the company's supervisory body. Under these cir-cumstances, it is often not necessary for the chief executive officer to provide selective information to "independent" directors, because of their formal independence outside directors are less likely to carry out their oversight responsibilities at the appropriate level.

3. Combination of the positions of the CEO and the Chairman of the Board. The probability of weak monitoring may also increase in cases when the CEO holds the chairmanship of the board. The main responsibilities of the chairman are to preside meetings of the board, set an agenda and ensure the smooth and orderly run of the board meeting (Murphy, 2019). The board of directors may delegate the power of the chairman to the CEO, thereby demonstrating its confidence and trust in his/her leadership abilities and competence. Nevertheless, obtaining chairman position allows CEOs to substantially strengthen their influence on the board and committees, as well as promote personal interests in the strategic board-level decision-making, such as executive compensations or director appointments. Furthermore, such a combination of positions allows CEOs to control the flow of information acquired by the board and, consequently, by the independent directors. It is noteworthy that long tenure also increases the likelihood of the CEO becoming chairperson of the board (Graham et al., 2017). According to the 2018 US Spencer Stuart Board Index, 50% of S&P 500 boards have positions of chairman and CEO combined, reflecting the prevalence of such practice.

4. Ignoring the advisory function of independent outsiders. Another essential detail of the interaction between independent board members and CEOs is these directors' function itself. Despite the fact that they are included on the boards for monitoring and advising, in general, the advising function fades into the background. As Adams and Ferreira (2007) suggest, the implementation of these two functions, which are different in nature, at the same time is quite difficult for members of the boards of directors. In most cases, independent outsiders are seen as the sole source of monitoring, although advising experienced outsiders can contribute to successful strategic decision-making. However, it is noteworthy that excessive focus on monitoring all decisions and actions of top executives is not a characteristic of the effective activities of independent outsiders. The requirement of intense monitoring from outsiders does not contribute to a successful cooperation between the board and senior management, but rather the opposite [7, pp. 178–180]. Actually, upper management members do not favor intense monitoring from directors and prefer not to provide valuable information to the board of directors which overzealously controls their decisions. The results of a survey conducted by Adams (2009) show that in cases of intensive monitoring of management activities, there is a considerable decrease in the information received by independent board members. Advising function in turn directly depends on information acquired from the CEO: the more complete and accurate information is provided by the CEO, the better is the board's advice. In other words, advising function can take place only with mutual trust and confidence between these parties.

For chief executive officers, providing independent directors with information regarding firm affairs is indeed a rather difficult decision. On the one hand, sharing significant firm-based information, CEOs are more likely to be provided with the better advice. On the other hand, providing information helps independent outsiders better recognize the possible options and opportunities of the company and, accordingly, strengthen monitoring and play a greater role in decision-making activities. A CEO facing intensive monitoring is less predisposed to share information. Hence, none of the parties succeeds in this bargaining game: neither independent directors obtain valuable firm-based information, nor the CEO receives necessary consultation and collaboration.

It is interesting to note that present-day listing rules (FindLaw, 2017), as well as legislation at the state level, require the creation of a number of committees consisting entirely of independent directors. These requirements, nonetheless, relate solely audit, nominating and compensation committees that primarily specialize in monitoring activities (OECD, 2019). The presence of independent outsiders on other board committees aimed at advising rather than monitoring, such as strategy & planning or corporate development committees, may ensure a balance between the two main functions of these directors. However, as the 2018 US Spencer Stuart Board Index illustrates, at the present, there is a relatively small percentage of companies with advisory committees, which is an additional indicator of the dominant position of monitoring over the advising function.

Conclusion. Contemporary corporate governance standards define the independence of directors as one of the principal indicators of the effectiveness of the board of directors as a protector of shareholder interests. In other words, independent directors in publicly traded companies with dispersed ownership structure are expected to oversee the most critical strategic decisions of the firm's management team. An extremely significant component of this function is the interaction with CEOs of the company since they are the sources of valuable firm-specific information.

However, the corporate governance structure of publicly held firms currently allows C-level executives to limit the activities of independent directors in the impartial control of their management decisions. Top managers, in particular CEOs who want to maintain and strengthen their influence over the company, are not interested in providing the necessary information to those who evaluate their performance and, in case of unsatisfactory results, can initiate their dismissal. Information asymmetry is considered by CEOs as a necessary means to maintain their dominant position. Thus, chief executive officers often prefer to use its influence to restrict the participation of outsiders in corporate decision-making processes.

Moreover, the current perception of the need for independent outsiders in public firms is almost entirely related to the supervisory role. Consideration and evaluation of the performance of independent directors solely from the point of view of monitoring, while disregarding the advising activities not only distort the image of these board members but also prevent the establishment of mutually beneficial cooperation between senior management and independent board members.

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