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STUDY ON CORRELATION BETWEEN CEO DUALITY AND CORPORATE PERFORMANCE OF COMPANIES LISTED ON THE BUCHAREST STOCK EXCHANGE

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Abstract

In Romania it is not recommended the duality of positions, the term "recommended" not being strictly kept, so there is a 33% case of companies listed on BSE that do not comply with codes of governance on the plurality of positions and the Chairman assumes the responsibility for the General Manager (CEO) of the company. 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. Using data of 55 listed Romanian firms from the Bucharest Stock Exchange in 2010-2013 we analyse the relationship between CEO duality and performance (Return on Assets) or between CEO duality and some variables which describe some characteristics of corporate governance (concentrated ownership structure, presence of general manager as a shareholder, presence of institutional investors, size of the Board, presence of a woman in the position of Chairman, age of Chairman or presence of one tier governance system). Empirical findings indicate that CEO duality is positively related with Return on Assets (ROA) which supports stewardship theory. The variable that shows the duality is positively correlated with concentrated ownership structure, the variable that shows the general manager is also a shareholder, size of the Board and the variable that shows position of Chairman is held by a woman, age of Chairman and negatively with the variable that show presence of one tier governance system.

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1. Introduction

A question to which we tried to give an answer within the research is duality enhances or inhibits firm's performance. Thus we have considered appropriate to test the relationship between duality of functions of General Manager and Chairman of the Board and corporate performance. Authors such as Fama and Jensen (1983), Felton (2004), Gillan (2006), Shleifer and Vishny (1997), Dahya and Travlos (2000), Rechner and Dalton (1999), supporters of the theory of agent believe that the duality of functions of General Manager and Chairman of the Board has a negative impact on corporate performance. In other research, advocates of stewardship theory (Adams, Almeida, et al., 2005, Davis, Schoorman, et al., 1997, Finkelstein, D'Avena, 1994) on the contrary, conclude saying that separation of functions has a positive impact on performance. Both theoretical and empirical studies are inconclusive as to which might be better: CEO and Chairman of the Board positions into one person or splitting the titles. The first objective of this study is to examine the relationship between CEO duality and the company's performance. Using data of 55 listed Romanian firms from the Bucharest Stock Exchange in 2010-2013 we analyze the relationship between CEO duality and performance (Return on Assets - ROA).

The second objective of this study is to examine the relationship between CEO duality and the some characteristics of corporate governance characteristics measured as dummy variables (concentrated ownership structure, presence of general manager as a shareholder, presence of institutional investors, presence of a woman in the position of Chairman or presence of one tier governance system). We'll use a panel model that followed, also, identification of the type of connection between CEO duality influence corporate governance factors. Empirical findings indicate that CEO duality is positively related with performance, but the regression coefficient are not significant. Also CEO duality is positively related with some characteristics of corporate governance (concentrated ownership structure, general manager's existence as a shareholder, presence of institutional investors, size of the Board, age of the Chairman or presence of a woman in the position of Chairman) and negatively related with the presence of one tier governance system.

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. Literature review

The separation of general manager's position of the Chairman of the Board of Directors is an important issue discussed in the literature which we have allocated a necessary space, because the duality practice is quite common in Romania too. In Romania it is not recommended the plurality of functions. In terms of duality, the theory comes with two different approaches, showing that in terms of agent theory duality negatively affects performance and the stewardship theory says the opposite.

The agent theory argues that the separation of the positions of General Manager and Chairman maximize the corporate performance, as the Board of Directors would have an impartial authority in overseeing the CEO (Gillan, 2006, Shleifer, Vishny, 1997). Most investigations have shown that agent problems resulting from the need to separate the control property (Jensen, Meckling, 1976, Fama, Jensen, 1983). Duality of functions is a problem because people who are responsible for the performance of the company are the same as those that assess effectiveness. Such an arrangement concentrates too much power in the hands of executive manager so we talk about many responsibilities that fall to the subject, which can lead to inefficiency.

Stewardship theory emphasizes that filling both positions by a single person would improve firm's performance; one person filling two positions can monitor the company carefully and have a firm-wide single command (Adams, Almeida, et al., 2005, Finkelstein, D'Avena, 1994). The basic elements of stewardship theory are based on social psychology, which focuses on managers' behaviour. Their behaviour is pro-organizational and collectivist, not egoistic or individualistic, which will depart from the interests of the organization as the manager seeks to achieve company's objectives, he is involved in the daily operations of the company, he will try to invest as much as possible, to increase firm's value and also his personal status (Davis, Schoorman, et al., 1997). Also, companies that do not have a separation of functions have also more shares held by the General Manager of the company, which could strongly align the interests of shareholders and General Manager.

The relationship between the company's performance and the decision of separation of functions of General Manager and Chairman of the Board is a negative/positive one.

3. Research Methodology

To test the validity of the hypothesis previously enunciated for the practice of companies listed on the Bucharest Stock Exchange there was selected a sample of 55 listed companies.

The analysis aims to identify the relationship between duality of General Manager - Chairman and performance of the company or of the duality of General Manager - Chairman and characteristics of management structures. The following section (Table 1) describes the basic features and variable notations that characterize the existence of general manager as a shareholder, the presence of institutional investors, size of the Board, presence of a woman in the position of Chairman or presence of one tier governance system, the concentrated ownership structure.

Table 1 Definition of variables used to test the correlation of duality - the characteristics of management structures - corporate performance.

VARIABILE	DESCRIPTION
Dependent variables	
ROA	Return on Assets
DUAL	Dummy variable: if the CEO is also the Chairman - 1 and 0 otherwise.
Independent variables	
TWO-TIER	Dummy variable: two tier system -1, and 0 otherwise.
OWN	Dummy variable: majority shareholders -1, and 0 otherwise.
INV. INST	Dummy variable there are institutional investors on the company - 1 and 0 otherwise;
INV. MAN	Dummy variable: the CEO is also shareholder - 1 and 0 otherwise;
NO. BOARD	The number of members of the Board of Directors.
CHAIRMAN FEM	Dummy variable: Female Chairman - 1 and 0 otherwise.
AGE CHAIRMAN	The Age of the Chairman of the Board of Directors.

The econometric analysis is based on regression models for estimating panel data, using Eviews program. Similar Baltagi (2005), we consider the following general form of panel data regression model without cross-sectional effects:

$$Y_{it} = \alpha_i + \beta \times X_{it} + u_{it}, i = 1,2, \dots N, t = 1,2, \dots T, \qquad (1)$$

where *Y* is the dependent variable (Return on Equity) on the one hand and *X* is the vector of independent variable (duality). The index *i* denotes the cross-section dimension, respectively the companies listed on the BSE, whereas *t* subscript denotes time, respectively the period 2010-2013. According to Baltagi (2005), most of the panel data applications employ a one-way error component model for the disturbances as following:

$$u_{it} = \mu_i + v_{it} \qquad (2)$$

where μ_i shows the unobservable individual-specific effect, whilst v_{it} shows the remainder disturbance.

To test the relationship between variable that indicates the existence of a duality CEO Chairman of the Board of Directors (*DUAL*) and other variables that characterize the corporate governance structures 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:

$$\Pr(Y = 1 | X) = \Pr(Y = 1 | X_1, X_2, ..., X_n), \text{ where Pr denotes probability,}$$

$$Y^* = \alpha + \sum X \times \beta + \varepsilon, \text{ where } Y = \begin{cases} 1, & \text{if } Y^* > 0 \\ 0, & \text{otherwise} \end{cases}.$$

In Figure 1 the two regression models are shown for which the results can be considered statistically significant. For the first model we tested the relationship between duality of General Manager - Chairman (DUAL) and company’s performance (dependent variable measured by return on assets).

Model 1: **ROA** = $\alpha + \beta_1 \times$ **DUAL** + u_{it}

Model 2: **DUAL** = $\alpha + \beta_1 \times$ **INV. INST** + $\beta_2 \times$ **INV. MAN** + $\beta_3 \times$ **OWN** + $\beta_4 \times$ **NO. BOARD** + $\beta_5 \times$ **CHAIRMAN FEM** + $\beta_6 \times$ **AGE CHAIR** + $\beta_7 \times$ **TWO-TIER** + u_{it}

Figure 1. Regression equations used to identify the relationship between the duality and the corporate performance or between duality and characteristics of management structures.

4. Empirical Results

The relationship between duality of General Manager - Chairman (DUAL), on the one hand and on the other hand the company's performance (ROA) is positive which confirms "stewardship theory" (Table 3 - Model 1). Results of authors Vintilă, Gherghina (2013) show that firm effect models show a positive influence of duality of General Manager-Chairman on the Tobin Q report adjusted dependent on industry, thus sustained stewardship theory and its supporters arguments being confirmed (Finkelstein, D’Avena, 1994).

Variable showing duality (DUAL) is positively correlated with variables OWN (concentrated ownership structure), INV.MAN (general manager is also shareholder), NO. BOARD (size of the Board) and CHAIRMAN FEM (position of Chairman is filled by a woman).

Concentrated ownership structure (OWN) has a positive impact on variable DUAL (duality of functions). Therefore, the conflict between management, board of directors and shareholders is minimal because these major shareholders want to have control over the company. Thus the Chairman and Manager are elected by the concentrated shareholders that want them to work together, and the best and effective decisions to generate a plus in the company are taken when present duality of functions.

Table 1. Empirical Testing on the problem of duality of the General Manager – Chairman.

MODEL	MODEL 1	MODEL 2
Dependent Variable	ROA OLS model	DUAL Binary model
Independent Variables	*Coef.* *t-stat*	*Coef.* *t-stat*
DUAL	0.269 (2.064)	
INV. INST		-0.25 (-1.146)
INV. MAN		0.555** (1.975)
OWN		0.397** (1.915)
NO. BOARD		0.098*** (1.915)
CHAIRMAN FEM		1.218* (3.084)
AGE CHAIRMAN		0.019*** (1.659)
TWO-TIER		-0.531*** (-1.682)
R^2	2%	
Probability	0.03	

*, **, and *** indicates the importance stage 1%, 5%, and 10%.

There are times when the general manager, shareholder is the same as the Chairman of the Board, so in addition to that there is no separation between executive function and the chairman function, it appears that the same person holds a significant percentage of company's shares, shares which provide a significant voting. Of the 55 companies listed on the BSE only 5 companies have as shareholder the general manager of the company (the same as Chairman of the Board). There is a positive relationship between duality and general manager's existence as a shareholder (INV.MAN). If the General Manager has an equity stake, this being interested in increasing the value of his shares, the maneuver is performed with much more advantage but also with cautious when General Manager is also the Chairman, him being the one taking the decisions to increase the company’s value and his equity stake value and also him adopting them.

The link between CHIARMAN FEM variable (position of Chairman is filled by a woman) and variable DUAL (existence of duality of functions) is a positive one. Most often based on the theory that women are more interested in cooperation and collaboration, they put more emphasis on positive and effective results, it is observed that in companies where women get on top management, they are sufficiently prepared or able to fill both positions, so on the company’s level to have a single command, which is carried out quickly and with expected outcomes.

From the summary in Table 3 it is observed that the relationship established between the variable NO BOARD (Size Board) and variable DUAL (existence of duality of functions) is a positive one. In a large company with a Board of Directors composed of many members is more suitable duality functions as; one person filling both positions can monitor closely the company or the work of other managers and may have a firm-wide single command.

A unique feature of corporate governance is represented by the possibility of choice between unitary and dual management structure. Companies have the choice between a unitary structure (one tier system) with a Chairman who may also be the chief executive officer (CEO) or a dual structure (two-tier system) with a Supervisory Board and an Executive Committee, the Chairman’s role being distinct of the CEO’s one. For companies listed on the Bucharest Stock Exchange it is observed that about 90% of listed companies practice the management unitary (one tier) system. The results in Table 3 - Model no.2 are significant and a negative impact is observed of a two tier system existence (TWO-TIER) on the duality General Manager – Chairman.

5. Conclusions

According to the “stewardship theory” the duality General Manager - Chairman is used to avoid confusion among managers, employees and other parties interested in the person from the top management of the company and facilitate decisions making more promptly and efficiently. Otherwise, the company may have conflicts on the management level, which could reduce the speed or the efficiency of decision making, ultimately, leading to poor performance. The relationship between company’s performance and functions duality of General Manager and Chairman is a positive one, which supports the application of "stewardship theory", on the capital market in Romania, where a 33% of the 55 companies included in the sample used for this research practice duality General Manager - Chairman.

The variable that shows a concentrated ownership structure has a positive impact on duality of functions. Therefore, the conflict of Management, Board of Directors and majority shareholders is minimal because these majority shareholders want to have control over the company; the Chairman and the Manager are elected by the concentrated shareholders. Thus these representatives of majority shareholders, holding both positions try to invest as much as possible, to increase firm’s value and maximize majority shareholders’ wealth that they represent and to increase their personal status.

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