GOVERNANCE SERIES

Boards and CEOs: Who’s Really in Charge?

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Deeply embedded in the credit union tradition is an ongoing search for better ways to understand and serve credit union members. Open inquiry, the free flow of ideas, and debate are essential parts of the true democratic process.

The Filene Research Institute is a 501(c)(3) not-for-profit research organization dedicated to scientific and thoughtful analysis about issues affecting the future of consumer finance. Through independent research and innovation programs the Institute examines issues vital to the future of credit unions.

Ideas grow through thoughtful and scientific analysis of top-priority consumer, public policy, and credit union competitive issues. Researchers are given considerable latitude in their exploration and studies of these high-priority issues.

The Institute is governed by an Administrative Board made up of the credit union industry’s top leaders. Research topics and priorities are set by the Research Council, a select group of credit union CEOs, and the Filene Research Fellows, a blue ribbon panel of academic experts. Innovation programs are developed in part by Filene i³, an assembly of credit union executives screened for entrepreneurial competencies.

The name of the Institute honors Edward A. Filene, the “father of the US credit union movement.” Filene was an innovative leader who relied on insightful research and analysis when encouraging credit union development.

Since its founding in 1989, the Institute has worked with over one hundred academic institutions and published hundreds of research studies. The entire research library is available online at www.filene.org.
I wish to express my appreciation to the hundreds of credit union and corporate CEOs, board members, regulators, and consultants who have helped me better understand and appreciate the complexity of the governance process. Over the past 25 years, they have generously shared their experiences and insights, and a surprisingly large number have candidly discussed their frustrations, disappointments, and failures. Leaders often tell me that they and their organizations substantially improve their governance processes when they honestly and courageously examine their limitations and mistakes. It is in this spirit that I incorporate some of their hard-learned lessons about governance into this report.

I thank Research Director Ben Rogers and the entire Filene Research Institute staff for their encouragement and assistance throughout the development of this research report. In addition, my special thanks go to Gary Clark, CEO of Missoula Federal Credit Union and a member of the Filene Research Council, for his very helpful review of this manuscript. Finally, I express my heartfelt appreciation to Colorado State University for championing and supporting applied and theoretical research.
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“Which is more important for the long-term success of your credit union: the board or the CEO?” I regularly ask credit union director audiences this question, and it always makes them uneasy, because it doesn’t have a clear-cut answer. The best CEO-board relations are symbiotic, with an informed and conscientious group of directors monitoring a capable and transparent CEO. In these situations, the question is an interesting intellectual exercise. The worst CEO-board relations are dysfunctional, with a micromanaging board, an incompetent CEO, power struggles, or one of a dozen other dark dynamics dominating the relationship. In these situations, the question underscores an existential threat to the credit union.

Yet one of the principal dangers in modern credit unions is that of autocrats and rubber stamps. The CEO, with all the information and all the resources, is easily tempted to rule the roost. The board, disconnected from the day-to-day and too often distant from important trends, is tempted to latch onto good news, trust the CEO (deservedly or not), and hope for the best. Warren Buffet once called corporate boards “tail-wagging puppy dogs,” and credit union boards should take that as a caution. If them, why not us? This is not to say all credit union governance is lax, but without diligence, it tends to be that way.

What Is the Research About?

Boards and CEOs: Who’s Really in Charge? is part two in a Filene Research Institute governance series, following Power and Governance: Who Really Owns Credit Unions? The final report is Boards and Leadership: How Boards Can Add More Value. All three take aim at credit union governance, both the good and the bad, and prescribe real-world responses.

Researcher Robert Hoel draws on an exhaustive literature review and decades of firsthand experience to frame each chapter with helpful conclusions, recommendations for credit union leaders, and hypotheses that, while not proven, are excellent to use in credit union boardrooms as conversation points for improving governance. The research literature on the governance of corporations is extensive, and Hoel mines it well for specific insights to improve the governance of credit unions.
What Are the Credit Union Implications?

CEOs have several advantages over boards of directors that tip the balance of power in their favor. They spend far more time on credit union business, control ongoing access to the full staff, and control the day-to-day expenditures of the credit union. Given these advantages, there is a danger that boards trust too much and abdicate their strategic and oversight roles.

The report recognizes and celebrates the inherent tension in even a healthy CEO-board relationship. It also recognizes the need to pick carefully through the tension while drawing (and enforcing) the right lines. The research takeaways include:

- Boards should recognize the rise of the CEO in credit unions and appropriately reward good CEOs. Nevertheless, trust in a good CEO should not lead them to abdicate their fundamental roles of oversight, inquiry, and evaluation.
- Boards should pay trusted, well-performing CEOs at or above market rates so that they are not constantly scanning for new opportunities. Be skeptical of claims about the organizational-performance-boosting powers of CEO incentive systems.
- Hiring a hardworking, experienced CEO who shares the credit union’s values and then rigorously monitoring that person’s performance is the board’s most important role. It’s not the only role, but it will cover a multitude of other sins.
- Boards should not micromanage, and board-CEO conflicts should be resolved (by outside moderators if necessary) as soon as possible. Delaying resolution could lead to firing the CEO or having board members resign.

The short answer to the “who is more important” question is neither. Superior performance springs from boards and CEOs that magnify their responsibilities while respecting the role of the other. Nobody wants autocrats, and nobody wants rubber stamps. Taking this research to heart will prevent both.
Robert F. Hoel, PhD

Bob Hoel is professor emeritus of business at Colorado State University. His primary research interests are in the areas of financial institutions, governance, marketing strategy, and consumer analysis. He frequently speaks about research findings and their implications to executives, board members, and professional groups across the United States and internationally.

During his career at Colorado State University, Bob has been a professor of business and chairman of the department of marketing. He received the university’s Outstanding Business Professor Award on three separate occasions.

His research has been reported extensively in academic and industry journals. His most recent Filene Research Institute publications are *Thriving Midsize and Small Credit Unions; Alternative Capital for U.S. Credit Unions: A Review and Extension of Evidence Regarding Public Policy Reform; Thriving Large Credit Unions; and Delivering Financial Education to Graduating College Students* (with W. Ronald Smith).

Bob is on the board of directors of the Credit Union Foundation of Colorado and Wyoming. He serves on committees of the Credit Union National Association and the Federation of Community of Development Credit Unions. He has been on the board of directors of two credit unions. For 15 years, he was CEO of the Filene Research Institute.

The National Credit Union Foundation presented Bob its 2008 Herb Wegner Lifetime Achievement Award for his many contributions to the success of credit unions, including his advocacy of objective, rigorous research about credit unions, consumer needs and preferences, and financial innovation. He has also been inducted into the Hall of Fame of the Credit Union Executives Society.

Bob received his PhD from the University of Minnesota, an MBA from Indiana University, a BA from Hamline University, and additional management education at Stanford University.
Insights for Better Credit Union Governance from Corporations?

*Boards and CEOs: Who’s Really in Charge?* is the second report in a three-part Filene Research Institute series on boards of directors and governance. The purpose of the research is to see whether a wide range of studies about the governance of corporations can help credit unions enhance the effectiveness of their boards of directors and governance processes.

All three research reports in this series find that credit union leaders can learn much about good and bad governance by examining the experiences of corporations and their boards of directors. Similarities in corporate and credit union governance issues are more numerous than generally understood. Furthermore, governance issues have been more thoroughly researched in private-sector, for-profit corporations.

In these reports, boards of directors and other credit union leaders will find recommendations that are likely to improve governance and performance of their institutions. They will also find intriguing hypotheses deserving additional research and analysis in individual credit unions and the industry. All recommendations and hypotheses flow from research about the experiences of corporations, credit unions, and occasionally of nonprofit, non-credit-union organizations.
CEOs have been rising in prominence and power in corporations and in credit unions in recent decades. In large part, this rise is merited, but boards should be cautious about ceding too much power.
CEOs Are a Talented, Experienced Bunch

CEOs are smarter and better educated than average employees. Almost all have toiled long and hard hours during their rise to the top, and they understand the business. Not only are they bright, hardworking, and knowledgeable, CEOs have sufficient street smarts and interpersonal skills to maneuver through the organizational maze to obtain their present positions. Few in public corporations and large credit unions inherited the CEO position through family connections. Successful CEOs who have family connections possess most leadership characteristics of CEOs without connections.

Hamori (2008) studied 500 corporate CEOs in the United States. She found that they are mature: 56 years old on average, with only 8% younger than 45. Thirty-eight percent have MBAs. Contrary to popular myth, they are not job-hoppers: On average, they have worked for only three companies during their professional career and have been employed in some capacity by their current company for 17 years. Their average tenure in the CEO position is 6.5 years.

Shrinking CEO Job Tenure

Despite CEOs’ considerable talents, long-term job security is not ensured and is becoming even less so. Booz & Company tracks chief executive succession at the 2,500 largest companies in the world. In 1995, 1 in every 10 US companies replaced its CEO. In the first decade of the twenty-first century, the frequency leapt to more than one in seven. The portion of departing CEOs dismissed for poor performance increased by a factor of four (Kelly 2010).

Given job insecurity and the possibility of burnout in the position, most CEOs want employment contracts with generous exit benefits. Golden parachutes (automatic payments made to the CEO and other managers if their firm gets taken over) may exceed more than $100 million (M); in one case, it exceeded $2 billion (B) (Kim, Nofsinger, and Mohr 2010, 121).
The Ascension of the CEO in Governance

The CEO is now the dominant actor in the governance process in corporations and in most credit unions. It wasn’t always this way. Historically in corporations, individuals who held a large percentage of a company’s stock frequently and persuasively expressed their concerns and made suggestions directly to management. They also made sure that one or more of their representatives served on the board.

In fledgling credit unions, the founders and earliest members typically managed the organization until it reached a sufficient size in which an office manager or general manager could be hired. Even following the appointment of a manager, credit union founders and early members kept a close eye on him or her and micromanaged the organization.

When a corporation or credit union substantially expands in complexity, scope, or size, governance power gravitates toward the CEO. The influence of large corporate stockholders diminishes as their power is diluted by the addition of new stockholders. The individual credit union member’s one vote becomes a smaller percentage of total votes as the organization expands. Because members of the board of directors serve on a part-time basis, they simply do not have sufficient time or often the expertise to make major decisions needed to run a large corporation or credit union.

Bright and able CEOs have several advantages over boards of directors that tip the balance of power in their favor:

- **Time.** CEOs work full time at the firm. Board members meet 6–12 times per year at corporations and monthly at credit unions. Few devote 40 or more hours per week to their task.
- **Staff.** CEOs have a full staff of corporate officers and support people at their disposal, while board members rarely have a full-time assistant or secretary.
- **Knowledge.** CEOs can directly and regularly tap internal financial, legal, and technical resources, along with the services of outside consultants.

Given these differences in resources, plus savvy CEO cultivation of strong personal relationships with individual board members, there is great danger that boards will place too much confidence in the CEO and will abdicate their responsibilities. CEOs often become autocrats, and boards become mere rubber stamps.
The Evolution of Leadership Titles

Parallel to the ascension of the senior executive in US corporations has been the elevation of the title of the senior executive. Over time, the title of manager became general manager and later managing director, chief executive officer, president, and president/CEO. “President, CEO, and chairman of the board” has become the most coveted and prestigious title. It clearly communicates to other board members, stockholders, other executives in the firm, and the business community that this person is the most powerful operational and governance player in the organization.

The top executives in credit unions are not immune from personal desires and possible business needs to elevate their titles. They want the respect and prestige afforded to their corporate counterparts. Boards have typically responded positively to their requests, and corporate-like titles are now the norm.

In the early days of small credit unions, the paid leader of the organization was often the “treasurer,” who was a member of the board. As credit unions became larger, the board might hire an “office manager.” This position later migrated to “manager,” suggesting prestige greater than mere board membership and the possible clerklike duties of an office manager. Next came the title “president,” which elevated the position to a perceived level of substantial additional autonomy. Today, the expanded and more prestigious title “president and chief executive officer” is preferred for the top executive in credit unions. The title of “president, CEO, and chairman of the board” is not available, because federal and state laws and regulations do not allow credit union senior executives to become chairs of their boards.

Credit union trade association governance and titles have also evolved as the industry has grown in size, complexity, and sophistication. At the national level, the senior paid executive of the association was called the “managing director,” and the leader of the board of directors was called the association’s “president.” Today, the prestigious title of “president” is assigned to the senior paid executive, and the title of “chairman” denotes the elected leader of the board. Similarly, the titles of leaders of state credit union leagues and associations have migrated. The titles “manager” and “managing director” have given way to “president” or “president/CEO.”

The Rise of Credit Union CEOs in Trade Association Leadership

In corporations, board members have rarely participated directly in trade association policy making. This function has been assigned to CEOs and their representatives.
Credit union CEOs did not always rule their trade associations. In the early days of US credit unions, board members and other volunteers played active and prominent roles in governance of the trades. Credit unions were more a social movement than an industry, and their leaders almost always called their collective efforts “the credit union movement.” Volunteers energetically participated in national and state credit union trade associations. They were inspired by national and state leaders who thought volunteers were the heart and soul of the movement. Directors believed that the volunteers’ knowledge of local member and community needs were valuable assets in shaping the national and state credit union agendas.

The power of volunteers in credit union trade groups has declined markedly over the last 40 years. Today, credit union CEOs hold the overwhelming majority of positions on boards of directors at trade associations. The last local credit union board member to be elected chairman of the Credit Union National Association (CUNA) was J. Alvin George in the late 1970s (Moody and Fite 1984, 284–85). Since then, CUNA chairs have been credit union and state trade association CEOs.

The same trend away from volunteer leadership also occurred in state and regional credit union leagues and associations. Credit union CEOs and other senior executives now control most leadership positions of associations and related credit union service organizations (CUSOs).

The transition away from highly active volunteers participating fully in trade association activities can be partially explained by the time demands of traveling and serving on national and state boards. Also, some trade association insiders believe the complexity of business and political issues requires more sophisticated and less vociferous debate than when large numbers of volunteers participate in association governance. In spite of this, trade associations are frequently successful in getting local credit union directors to participate in political events to influence legislators and other public officials.

Trade associations operate differently without local credit union directors playing key roles in their governance. Old-timers regularly report that meetings are less exciting and chaotic than they once were. The credit union movement is now an industry.
Conclusions, Hypotheses, and Recommendations

Conclusions
• CEOs in corporations and credit unions are, in general, smart, experienced, and savvy.
• CEOs dominate the governance process in most corporations and credit unions.
• CEOs want prestigious titles, respect, and power.
• CEOs possess much more power than board members to shape their industry, including its values and priorities.

Hypotheses for Further Testing
• The change from a movement to an industry will have an enormous impact on the future of US credit unions. For example, credit unions will become more banklike.
• Compared to average board members, the CEO has more managerial and policy experience and a higher emotional quotient (EQ). These differences contribute to CEO-board conflict and suboptimal credit union performance.

Recommendations to Credit Union Boards
• Recognize your CEO’s desire for prestige and respect and grant him or her an appropriate title and an expense allowance reflecting that title.
• Do not abdicate fundamental board roles and responsibilities despite the “rise and rise” of the CEO in your credit union and the industry.
• Pay some attention to the policy decisions and actions of state and national credit union organizations so that the spirit of the credit union movement does not totally disappear.
In addition to guiding the CEO, the board is responsible for thoughtfully controlling the CEO. This is not a license to micromanage; instead, it entails the careful use of compensation and designing metrics that will keep the CEO close to the board’s vision of good performance.
Controlling CEO Temptations

Potential Temptations

As noted in *Power and Governance: Who Really Owns Credit Unions?*, the first report in this Filene series on governance, organizations face potential agency problems when the CEO acts in a manner that is personally beneficial but is not in the best interest of the organization’s owners. Kim, Nofsinger, and Mohr (2010, 14) provide examples of self-serving managerial actions:

- Shirking (i.e., not working hard).
- Hiring friends.
- Consuming excessive perks (e.g., purchasing extravagant office furniture, misusing company cars, and exploiting large expense accounts).
- Building empires (i.e., making the firm as large as possible even though it may reduce the firm’s per share value [or benefits to the credit union’s existing members]).
- Taking no risks or chances, to avoid being fired.
- Having a short-run horizon if near retirement.

Other research and governance analysts provide numerous other examples of self-serving CEO actions, including:

- Participating excessively in industry, political, and civic organizations and activities.
- Placing CEO offices in overly prestigious and expensive office buildings.
- Featuring CEOs in advertisements when the ads are ineffective.
- Locating the CEO in a remote top-floor suite far removed from the realities of managers, customers, and the marketplace.
- Constructing and remodeling the primary residence, second homes, and retreats owned or almost exclusively used by the CEO and family for nonbusiness purposes.
• Constructing and operating an art museum to house the CEO’s personal art collection (Occidental Petroleum did this at the insistence of its then CEO Armand Hammer) (Hughes 1991).

• Using staff, aircraft, and company retreats for personal, family, and other nonbusiness activities.

Board Control of CEO Temptation: Separating the CEO and Chair Positions

Preventing CEO abuse of power and steering the CEO's energy to best serve the organization usually require boards of directors to play active and effective roles in the governance process. According to Garratt (2003), boards must perform their proper duties and not be overwhelmed by “the rise and rise of the chief executive.”

The tasks of controlling and directing are especially difficult in corporations where the CEO simultaneously serves as chairman of the board. When this is the case, CEOs may unilaterally organize the agendas and determine what information is transmitted to board members. CEOs may withhold negative information, downplay its importance, or bury it in thick documents. A result is the “rubber stamp” corporate board.

In credit unions, CEOs often are de facto chairs even though laws and regulations prevent them from officially being the board chair. Sometimes this occurs because the board is so impressed with the CEO’s abilities that it acquiesces to his or her every desire. It also may occur when the official board chair is unable or unwilling to perform standard chair duties. Sometimes the entire board may be so weak that it will not stand up to an aggressive CEO. Whatever the cause, the result is a “rubber stamp” board.

The Two Most Important Ways to Control Corporate CEOs

According to most corporate governance experts, the most important step in controlling CEO action and performance is to select a great CEO. The second is to effectively monitor the CEO and corporate performance. For example:

• The Business Roundtable (2010), representing the largest corporations, says, “First, the paramount duty of the board of directors of a public corporation is to select a chief executive officer and to oversee the CEO and senior management in the competent and ethical operation of the corporation on a day-to-day basis.”
The American Law Institute (1994, Sec. 3/02) says the board’s first responsibility is to “select, regularly evaluate, fix the compensation of, and, where appropriate, replace the principal senior executives.” Its second board responsibility is to “oversee the conduct of the corporation’s business to evaluate whether the business is being properly managed.”

Selecting and Monitoring CEOs—Credit Unions

As in corporations, selecting the CEO and monitoring performance are among the most important tasks of a credit union board of directors. The widely used _Credit Union Board of Directors Handbook_ emphasizes that the board is ultimately responsible for making sure the credit union is capably managed by a knowledgeable CEO and experienced staff (Credit Union National Association 2000, 44).

A study of a wide range of board tasks in 1,500 credit unions found that high credit union performance was most highly related to the following tasks (Hautaluoma et al. 1993):

- Managing CEO accountability.
- Planning and evaluating effectiveness.

Another study of credit union governance measured correlations between governance and credit union financial performance (return on assets). The only governance practice that yielded a strong positive correlation was whether the boards felt they had an effective CEO evaluation program in place (Chen, Spizzirri, and Fullbrook 2010, 34).

The Policy Governance Model for Nonprofits

Carver and Carver developed the Policy Governance model for use primarily by nonprofit organizations (Carver 1997; Carver and Carver 1997). It not only provides a comprehensive approach to governance but also offers fresh ideas about how the board of directors might direct and control the CEO. Many credit unions have fully or partially adopted the model.

Using the Policy Governance model, the board defines “ends” that describe its expectations about (1) the benefit, difference, or outcome in consumers’ lives that the organization is to produce, (2) the persons for whom the difference is to be made, and (3) the cost of the benefit. In other words, the ends define the value to be produced, the target market to receive the value produced, and the cost of producing value. By explicitly defining the ends, the board provides...
itself, the CEO, and all others involved in the governance process with a clear sense of desired outcome.

The Policy Governance model also calls for the board to determine “executive limitations,” which act as a control of CEO power. Executive limitations set boundaries that the CEO cannot go beyond. For example, an executive limitation might state that a credit union CEO cannot permit any actions that violate laws, regulations, or generally accepted ethical standards. Another might state that the CEO may not permit actions that would reduce a credit union’s capital ratio below 7%. Under the Policy Governance model, the CEO may do anything in pursuit of the organization’s ends as long as his or her actions do not violate the board-determined comprehensive set of “don’t do it” executive limitations.

Monitoring and evaluating are central to the Policy Governance model. The board needs to continually monitor and evaluate achievement of the ends and verify that the CEO is not going beyond the predetermined executive limitations.

An International Perspective on Controlling CEO Power
Concern about the rise of CEO power and its potential abuses exists in many nations. Hindle compares control of corporate CEO behavior in several countries. In the United States, he says, CEOs are given free reign to run things much as they like. American boards are “stuffed with cronies of the CEO,” and the CEO in most large corporations is also the chairman of the board. In the United Kingdom, public companies often separate the roles of chairman and chief executive, giving (in theory) a heavy counterweight to the CEO’s otherwise “unbridled ambition.” In Germany, companies have two boards, the managing board and the supervisory board. The latter carefully watches over the actions of the CEO. In France, CEOs tend to be watched by the government, and boards typically include someone who is or was a senior politician (Hindle 2008, 43–44).

Executive Compensation to Direct CEO Behavior

Compensation Controversies
Few governance topics are more complicated and contentious than CEO compensation. There are even debates about what constitutes compensation, and few comparative compensation reports capture all possible compensation components. In a broad sense, compensation includes salary, many forms of deferred income, incentive pay, bonuses, stock options, life insurance, medical care packages, golden parachutes, retirement programs, automobile and plane privileges,
prestigious offices, use of retreats, spousal benefits, and an array of expense allowances ranging from clothing to apartments and second homes near worksites to personal care services.

Of course, there are also the usual questions about the amount of total compensation, the ways that it is determined and awarded, and its effectiveness in directing and controlling CEOs. Additionally, regulators are concerned that performance incentives may encourage excessive risk taking.

Stock Awards in Corporations
Stock awards and options play a major part in compensation programs for most corporate CEOs in the United States. Advocates argue that stock options align the goals of the CEO with the corporate goal of increasing stockholder value. In most stock option plans, the CEO and other selected executives are given the option to purchase a block of the firm’s stock at a strike price set at the time of the award. The strike price is usually the market value at the time of the award. Theoretically, because of the stock awards and options, the CEO will make extraordinary efforts to increase the share price, and the CEO and stockholders will prosper simultaneously.

Total CEO Compensation in Corporations
In 2009 total compensation of the CEOs of the 500 largest companies in the United States (as measured by a composite ranking of sales, profits, assets, and market value) averaged $8M. Salary was often a minor part of the total package. The top earner in 2009, the CEO of Danaher Corporation, drew just a $954,000 salary but realized $84M from the exercise of vested stock options and $56M from the vesting of stock awards. All five of the most highly compensated CEOs over the most recent five-year period earned relatively small salaries in comparison to other types of compensation received. The most highly paid CEO over the five-year period received nearly $1B in total compensation ($5M in salary and $980M in value realized on exercised vested stock options) (DeCarlo 2010).

Total compensation for corporate CEOs has risen dramatically in the United States. After adjusting for inflation, CEO compensation in 2009 more than doubled the CEO pay average in the 1990s, more than quadrupled the CEO pay average in the 1980s, and ran approximately eight times the CEO average in all decades of the mid-twentieth century. These substantial increases occurred even though CEO compensation dropped in 2007, 2008, and 2009 because of a severe economic downturn (Anderson et al. 2010).

Corporate CEOs have done much better financially than their employees. American workers, in contrast to CEOs, receive less
in real weekly wages than they did in the 1970s. The Institute for Public Policy calculates that CEOs of major US corporations average 263 times the average compensation of American workers. Using this same methodology, in the 1970s few top executives made over 30 times what their average workers made (Anderson et al. 2010).

Peter Drucker, echoing the view of famous financier J. P. Morgan, believes that the ratio of pay between executive and worker can run no higher than 20:1 without damaging company morale and productivity (Drucker, Managing in the Next Society 2002, 150, also quoted in Wartzman 2008).

**Do CEO Incentive Programs Improve Corporate Performance?**

Most independent researchers answer “no” or “not much” to the question of whether CEO incentive programs improve corporate performance. Considerable academic research about managerial compensation followed the publication of a seminal paper by Jensen and Meckling (1976) on agency conflicts and compensation. In general, academics have not found a strong positive relationship between CEO compensation and corporate performance.

Though Jensen and Meckling argued that the design of the managerial pay package is a potent tool to align management and shareholder interests, Jensen and Murphy (1990) later found that the equity holdings of a CEO have only a weak relationship with the gains and losses of shareholders. Bebchuk and Fried (2004) found that options have little positive impact on shareholder value, and they contend that increases in CEO option grants have merely been a ruse to increase total CEO compensation. Zweig (2009) reported on the preliminary findings of Rau and two colleagues, who looked at CEO compensation in 1,500 companies from 1994 to 2006. The researchers found that the 10% who are the highest-paid CEOs produce stock returns that lag their industry peers by more than 12 percentage points, cumulatively, over the subsequent five years. After reviewing the literature, Zweig (2009) concluded, “It’s high time for corporate compensation committees—and investors—to start doubting whether the lavish pay packages they endorse actually work.”

Lawmakers and regulators have recently expressed considerable concern about problems arising from executive compensation programs, most of which include incentives. One of the fears is that pay-for-performance incentives may encourage excessive risk taking that contributes to financial crises like the 2007–2010 downturn.
that contributes to financial crises like the 2007–2010 downturn. A partial list of recently enacted proposals follows:

• Disclosure
  ▪ Corporations must compute and report the median compensation of their employees, excluding the CEO, and reveal the ratio between CEO pay and employee pay.
  ▪ Corporations must disclose the relationship between executive pay and corporate financial performance, including changes in share prices over the previous year.
  ▪ Corporations must disclose whether they have a policy on hedging by employees or directors.
  ▪ Government contractors and subcontractors must annually disclose the names and total pay, including bonuses and stock options, of their five top-paid officers.

• Governance
  ▪ Firms must provide stockholders the right to a nonbinding vote on compensation arrangements (“golden parachutes”) that are triggered by a merger or acquisition.
  ▪ All board compensation committee members must be independent (not corporate executives or employees).
  ▪ Firms must disclose whether the board compensation committee obtained the advice of a compensation consultant and whether the consultant’s work raises any conflict-of-interest issues. The SEC has been directed to identify criteria for determining the independence of an adviser to the compensation committee.

• Special requirements for banks and savings and loan companies
  ▪ The Federal Reserve must develop standards to prohibit payment to any officer or board member of
    — Excessive compensation, fees, or benefits.
    — Compensation that could lead to material financial loss to the bank holding company or savings and loan company.

CEO Compensation in Credit Unions
Because credit unions do not issue stock, they cannot offer CEOs stock awards and options to incentivize CEOs. Instead, credit unions rely heavily on base salary plus bonus and cash incentive programs. Given the questionable effectiveness of stock options in managing corporate CEOs, credit union reliance on other tools is not necessarily a major problem.

Salary is the largest component of total compensation for credit union CEOs. On average in 2009, base salary accounted for 86% of
total compensation for CEOs at credit unions with assets of $100M or more. The mean base salary amount for these credit unions was $185,496 in January 2010. Nearly 60% of CEOs received a bonus and/or incentive award in 2009, and median variable pay (bonus and/or incentive payments) was $16,345. Breaking down variable pay for 2009, 39% of CEOs received bonuses—after-the-fact rewards for a job well done. Additionally, 35% have incentive plans where rewards are tied to preset expectations and performance levels. About half the CEOs covered by incentive plans earned an incentive payment. All these dollar amounts and percentages were down from the previous year because of problems in the economy in general and in finance industries in particular (Credit Union National Association 2010a).

The ratio of CEO compensation to average employee compensation is lower than comparable ratios in corporations. For credit unions with more than $100M in assets, the ratio of average CEO base salaries to average nonmanagement salaries is less than 10. In the largest 2% of US credit unions (those with more than $1B in total assets), the ratio is comfortably less than 20. These low ratios are particularly noteworthy because credit union CEOs receive the bulk of their pay in the form of base salary, with a relatively small amount of bonus and incentive income. In contrast, Kevin Hallock, director of research for the Center for Advanced Human Studies, estimates that base salary is less than 15% of total pay for CEOs of very large companies and about 40% of total pay for smaller companies (Credit Union National Association 2010b).

As shown in Figure 1, total cash compensation of bank CEOs overall is higher than for credit union CEOs. One asset-size group where total cash compensation is about equal is the $500M–$1B range. The compensation shown for bankers does not include stock options and grants they may receive.

Are Credit Union CEO Salaries Too Low?
Credit union boards might be concerned about comparatively low CEO cash compensation for three reasons:

- **The amount may not be sufficient to motivate the CEO to perform well.** There is no empirical evidence supporting this concern, but there is some anecdotal evidence that low compensation may be demotivating, especially in smaller credit unions.
- **A credit union CEO may resign and take a CEO position at another credit union.** There are many examples of this occurring, and it typically involves a CEO moving up to a larger credit union.
- **Low compensation may cause credit union CEOs to accept positions as bank CEOs.** There is no evidence to support this concern. In
fact, the present research was unable to identify a single case of a credit union CEO becoming a bank CEO. On the other hand, there are many examples of the reverse occurring. Either being a credit union CEO is a very good gig that compensates sufficiently well, or banks do not believe credit union CEOs are qualified for bank CEO positions.

**Unique Incentive Schemes for Credit Union CEOs**

Speakers at a Filene colloquium agreed that credit unions must carefully link compensation systems with their business plans, which may be very different from bank plans. Compensation systems should reflect the long-term challenges the credit union expects to encounter and should emphasize the directions that the credit union wishes to take. Compensation systems must align objectives and rewards (Lawler III, Deci, and Zingheim 2001).

Credit unions can use stock-option-like incentives. Lawler and colleagues believe that credit unions can develop a “performance unit plan” that serves as an effective alternative to stock options. A performance unit mimics the provisions of a stock option. In a

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**Figure 1: Median CEO Total Cash Compensation at Credit Unions and Banks**

<table>
<thead>
<tr>
<th>Asset size</th>
<th>Credit union</th>
<th>Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>$197,236</td>
<td>$311,578</td>
</tr>
<tr>
<td>Under $500M*</td>
<td>$167,150</td>
<td>$301,432</td>
</tr>
<tr>
<td>$500M–$1B</td>
<td>$273,560</td>
<td>$466,703</td>
</tr>
<tr>
<td>$1B or more</td>
<td>$301,432</td>
<td>$421,242</td>
</tr>
</tbody>
</table>

*Credit union data limited to credit unions with $100M or more in assets.

**Sources:** CUNA and the Delves Group’s 2009 Bank Cash Compensation Survey.
performance unit plan, a credit union creates performance units at a certain value, for example, one dollar. If the credit union is highly successful, the value of the performance unit goes up, possibly to two dollars. The CEO or other credit union executive would get the difference between one and two dollars, times the number of units they hold (Lawler III, Deci, and Zingheim 2001, 57).

Credit unions may choose to tie their CEO performance plans to the quantity and quality of member benefits generated instead of financial performance metrics. In a previous Filene report, Boeing Employees Credit Union described its incentive plan to encourage senior managers to focus on member value and the long-term strategic direction of credit union services. The plan consists of two components: (1) 5% of each participant’s salary is set aside into a deferred pay plan and appreciates by the value returned to members over four years and (2) a mitigation factor to make sure that incentives do not sacrifice the safety and soundness of the credit union. The Boeing plan measures return to members by comparing the credit union’s rates and fees with those of other credit unions and other market-leading financial institutions across the country (Oakland, Tippets, and Levine 2002).

In the same Filene report, American Airlines Federal Credit Union showed how it ties its measurement metrics to the performance of two peer groups of credit unions that are leaders in providing member service. Its program focuses on six components: (1) average dividends paid to members, (2) average loan yield, (3) growth in loans outstanding per employee, (4) delinquency and charge-off ratios, (5) member satisfaction, and (6) the CAMEL rating of the National Credit Union Administration (NCUA).

Conclusions, Hypotheses, and Recommendations

Conclusions

• Corporate and credit union governance systems are riddled with potential agency problems. Consequently, boards and owners must maintain high levels of vigilance, including ongoing governance control mechanisms.
• Permitting an individual to be CEO and chair simultaneously is undesirable. When credit unions combine these positions, it is de facto rather than explicit.
• Selecting good CEOs and monitoring them vigorously are the two most important board tasks.
• CEO incentive programs rarely improve corporate performance.
• Compared to credit union CEO compensation programs, bank CEO compensation programs are much more heavily weighted toward variable incentive pay.

Hypotheses for Further Testing
• At least 80% of CEO incentive programs in credit unions do not improve credit union performance.
• Credit union CEOs who were internal candidates for their present position outperform CEOs who were external candidates.
• A significant minority of small credit union CEOs underperform because they are undercompensated.

Recommendations to Credit Union Boards
• Hire a very bright, experienced, and hardworking CEO who shares your credit union’s values. Then monitor the CEO’s performance intelligently and rigorously. If you do these two things extraordinarily well, you can underperform on many other board duties and the credit union will probably be just fine. However, underperformance on other board duties is not recommended if you want a great credit union.
• Don’t overlook existing talent on your credit union’s staff when selecting your next CEO. Selecting an internal candidate is typically the best strategy in corporations, contrary to what you might expect if you watch lots of financial news programs. (See Chapter 1.)
• Pay your CEO appropriately, and be skeptical of claims about the organizational-performance-boosting powers of CEO incentive systems.
Boards and CEOs must perform well together for the good of membership, but differences are inevitable. Left to fester, disagreements or mismatched styles can bloom into conflicts. Boards and CEOs alike share the responsibility to be transparent and address problems early.
Board-CEO Conflicts in Corporations

How well the board and the CEO work together can be a significant factor in determining the output and success of a corporation. Because the goals of corporate boards and CEOs do not perfectly match, conflicts arise. The board typically wants to direct and control the CEO to ensure that the CEO carries out his or her duties. While CEOs may want to carry out assigned duties as their boards wish, they also have personal goals and agendas that may be at odds with board goals and expectations. Furthermore, personality conflicts and work-style differences may produce tension in the relationships.

Conflict resolution strategies in corporations range from reluctant acceptance of differences to termination of the CEO or resignations by some board members. CEO termination is not the preferred option, because a relatively unproductive hiring, learning, and adjustment period may follow.

Researchers have observed how dynamics of CEO-board relationships evolve. Shen (2003) recommends that new CEOs be given a “honeymoon period” during which they have latitude to acquire needed task knowledge and skills without worrying about being dismissed during their learning process. Shen found that the use of outcome-based compensation in early CEO tenure has a negative impact on CEO leadership development. He also found that the use of behavior-based compensation in early CEO tenure has a positive impact on CEO leadership development.

One researcher found that the use of outcome-based compensation in early CEO tenure has a negative impact on CEO leadership development.
Good and Bad Board-CEO Relationships in Credit Unions

Credit unions are subject to board-CEO tensions similar to those found in corporations. Hautaluoma, Donkersgoed, and Morgan (1996, 2) identified relevant aspects of good and poor relationships in credit unions. During their research, four behavioral dimensions were repeatedly mentioned by CEOs, board chairs, directors, and regulators when describing both good and poor relationships:

- **Trust between the board and the CEO** refers to both parties believing that the other is honest and fully discloses pertinent information. It includes feeling safe to admit mistakes and discuss negative information with each other. It also refers to an open interaction among the board, CEO, and staff. There is trust that the other party will keep agreements and act in the credit union's best interest. This behavioral dimension was cited by both CEOs and directors as necessary for a healthy, effective relationship, and it was notably absent in poor relationships.

- **Micromanaging** is the degree to which the board becomes directly involved in operational matters. Examples include the board communicating directives to staff, making personnel decisions, and helping to run the credit union on a day-to-day basis. Micromanagement was often present in poor CEO-board relationships and absent in good ones.

- **Board role clarity** refers to an understanding and knowledge among directors about their working role in the credit union. It also refers to properly differentiating the director’s role from the CEO’s role. In good CEO-board relationships, board roles were clearly understood. In poor relationships, board roles were often ambiguous and unstable and overlapped with the CEO’s role.

- **Building communication and trust** refers to the CEO providing clear, accurate, and proper amounts of information to the board, both positive and negative. It also refers to communicating with the board as equals, keeping the board fully informed, quickly involving the board in major issues, and requiring that staff presentations to the board be clear and informative. Poor communication often generated mistrust and ineffective relationships.

Remedies for Ailing Board-CEO Relationships

The credit union study by Hautaluoma, Donkersgoed, and Morgan (1996) also surveyed CEOs and directors regarding the effectiveness of actions to remedy the effects of poor CEO-board relationships. The researchers found that communications and facilitated
Conflict-resolution meetings work best during the early stages of a poor relationship, but their effectiveness declines dramatically when the relationship further deteriorates. These conflict-reducing remedies are not very effective in later stages of a poor relationship, because they often fail to correct the characteristics of the survivors or the manner in which they conduct CEO-board relationships. Firing the CEO and getting board members to resign are better remedies in later stages of conflict. Also, external interventions, such as regulator directives and mandates from supervisory committees, tend to be very effective because they can clarify roles, responsibilities, and expectations within the relationship.

Conclusions, a Hypothesis, and Recommendations

Conclusions
• It is normal to have some degree of conflict between boards and CEOs.
• Resolving conflict through CEO termination is not the generally preferred option.

A Hypothesis for Further Testing
• New CEOs will benefit from special training and mentoring programs focusing on the development and maintenance of effective board-CEO relationships. Their credit unions benefit, too.

Recommendations to Credit Union Boards
• To minimize board-CEO tensions, build trust, avoid micromanaging, and make sure all board members understand their roles and boundaries.
• Resolve board-CEO conflicts as soon as possible through better communication and facilitated conflict-resolution meetings. Delaying resolution often requires firing the CEO or getting board members to resign.
2. Hamori also studied 500 CEOs in European corporations and compared them with American CEOs.
3. Adapted from a list developed by the Institute for Policy Studies (Anderson et al. 2010).
4. Calculated by author from CUNA survey data (Credit Union National Association 2010b).


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