

# When divided loyalties make for better executives

June 20 2024, by Benjamin Kessler

---



Credit: Pixabay/CC0 Public Domain

It's well-known that servants with two masters are often conflicted. But they can also be uniquely knowledgeable, especially when one master wants to know what the other is up to, or the interests of the two

coincide.

Case in point: At most publicly traded U.S. firms, the chief legal officer (CLO) doubles as the corporate secretary (CS). That means the senior executive responsible for advising management on legal matters is also a key player in steering the board's agenda. CLO duality, then, potentially opens the door to conflict of interest. That seems to have happened, for example, in the case of Nancy Heinen, formerly Apple's CLO/CS, who allegedly used her double affiliation to help cover up [illicit backdating of stock options](#) adding up to nearly \$40 million.

Yet from the standpoint of shielding the organization from liability, CLO duality has obvious structural advantages, which is why it has become common practice.

JK Aier, senior associate dean and associate professor of accounting at the Costello College of Business at George Mason University, describes CLO duality as a trade-off between being "informed and [being] independent." His [recent working paper](#), co-authored by Justin Hopkins of University of Virginia and Syrena Shirley of Columbia University, explores how this trade-off works in reality by investigating actual outcomes.

Aier and his co-authors compared the legal histories of firms with CLO duality to those of firms that separated the two roles. Their data-set included securities class action lawsuits, regulatory enforcement actions and the dollar amount of associated penalties.

"We were surprised by what we found," Aier admits. "It's kind of counterintuitive."

Firms with CLO duality were significantly less likely to face lawsuits, and to be found liable for regulatory violations. When they did run afoul

of regulators, their fines were much smaller on average (\$1.7 million vs. \$5 million), indicating a much lower level of seriousness.

In most cases, therefore, firms may be rational in choosing the informational efficiencies of CLO duality over the ethical safeguards of separation. But Aier advises that the trade-off has no universal solution.

Breaking out the data sample by firm characteristics helped the researchers identify some probable motivators of CLO duality. There was, for example, a [direct relationship](#) between the proportion of independent directors on the board and the propensity to combine the CLO and CS roles.

Aier speculates that more independent boards are already at a sufficient remove from management. "If a CS is acting like management, outside directors could neutralize that by asking more questions," Aier explains. For these boards, the legal acumen of the CLO offers more value than a stand-alone CS.

In addition, firms whose CEO was also board chair tended to opt for separation, again pointing to the relevance of pre-existing ties between the board and management.

Also more likely to opt for separation were larger and older firms, as well as firms with especially high stock-market returns. "When complexity increases, you're more likely to see separation," Aier says.

Finally, firms that operated in industries with higher risk of litigation (tech, retail, etc.) tended to prefer separation.

A [growing number](#) of [voices](#) within the corporate governance community are advocating for the CS as a stand-alone position, citing undue ties between management and the board as a key concern. But for

Aier, "There's no one-size-fits-all option. Duality should not be seen as a no-no. It can be an opportunity that provides value that is not immediately obvious."

But what about the divided loyalties that led to legal disaster in the Nancy Heinen case? "It appears Nancy was the proverbial 'one bad Apple,' no pun intended. An example like this should not be so influential and define corporate structure. Instead, the best possible structure should be determined by the duty of the board, which is to provide oversight."

Aier believes these findings may have implications pertaining to larger questions concerning corporate governance, conflict of interest and the role of regulators. He suggests policymakers should avoid adopting a rigidly interventionist agenda that views duality as an inherent structural problem.

"Regulators and policymakers need to ask, 'Are these proposed governance changes necessary? Or are we making it more challenging for businesses?'"

**More information:** Working paper: [www.acc.com/sites/default/file .../2024-03/Independent%20Or%20Informed.pdf](http://www.acc.com/sites/default/file.../2024-03/Independent%20Or%20Informed.pdf)

Provided by George Mason University

Citation: When divided loyalties make for better executives (2024, June 20) retrieved 25 June 2024 from <https://phys.org/news/2024-06-loyalties.html>

This document is subject to copyright. Apart from any fair dealing for the purpose of private study or research, no part may be reproduced without the written permission. The content is provided for information purposes only.