Subsidiary Governance – it's not that simple

Subsidiary governance is a big subject with a lot of complexities and variations. In a short time, it isn't possible to cover all the permutations in great depth, so inevitably this is somewhat at a high level, however we aim to share a few key elements of our thinking, which may help you to think through some of the quandaries you may be facing.

We are aiming to give you a way of thinking through:

- **what "subsidiary governance" means for you;**
- **a framework for thinking through subsidiary governance issues;**
- **to share some experiences of pitfalls and the sorts of things that might be tackled;**
- **and a suggested approach.**

We emphasise that thinking through the role of the governance structures needs to take place before working out practical solutions. The principles we suggest should still apply if you have management-based governance structures – although boards certainly do introduce an extra element of complexity.

Subsidiary governance can mean different things to people in different organisations, and, more confusingly, it can even mean different things to people within the same organisation. It used to be almost entirely a question for financial services driven by regulatory and legal requirements, and by the risk and control angles – this resulted in a need for local boards and, in some cases, local audit and risk committees. It wasn't really an issue for non-financial services firms, as for them everything was driven through the management line. Now, the need is changing, and there is more of a push for all sorts of organisations to clarify how their subsidiary governance is working. A clear picture is needed, with understanding of the sources of comfort and control throughout the organisation. Or, perhaps to look at how, for example, anti-bribery and corruption policy and procedures are driven throughout.

Too often, we see a lack of clarity and understanding around subsidiary governance and its purpose. We see a lack of visibility, a lack of two-way flow, wasted cost, and missed opportunities. When it works well, subsidiary governance gives structure and clarity, relieves internal tensions, and allows a focus on execution. There are all sorts of benefits to getting it right.

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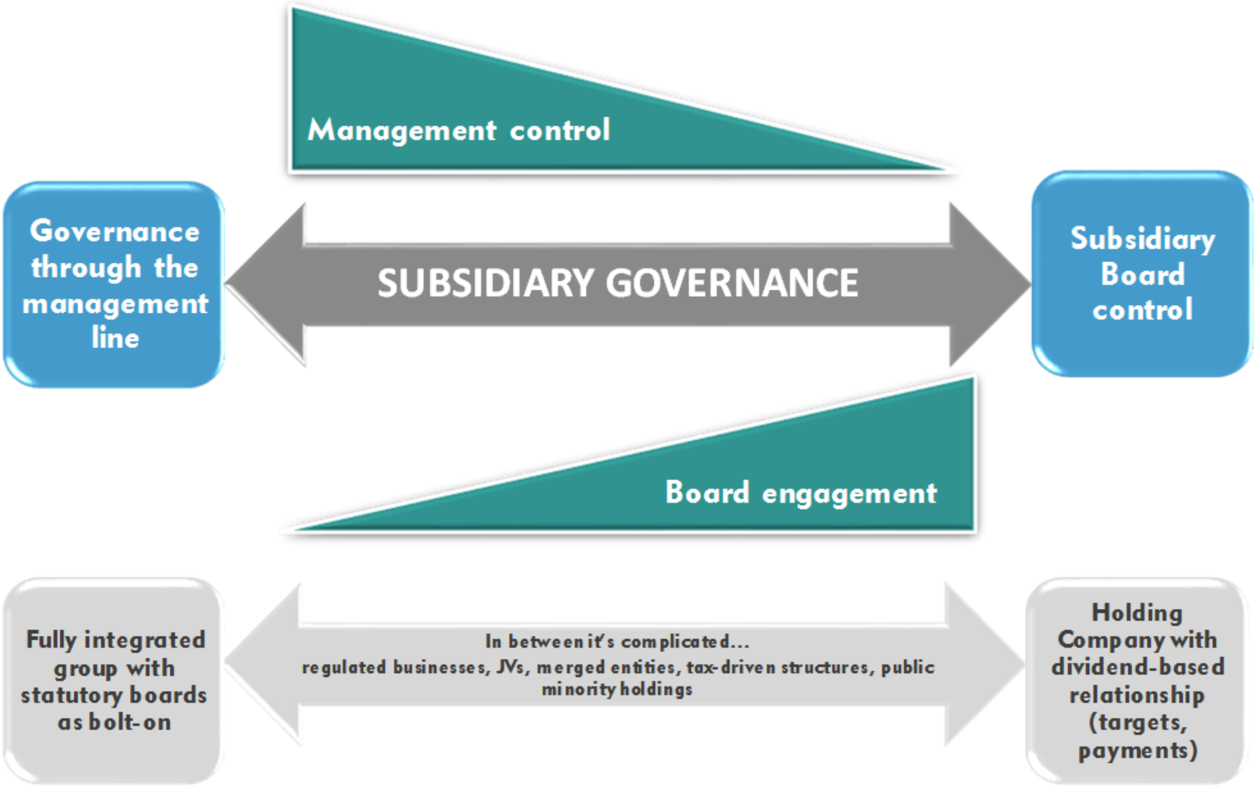
INDEPENDENT AUDIT
BOARD REVIEW

You're somewhere on the spectrum

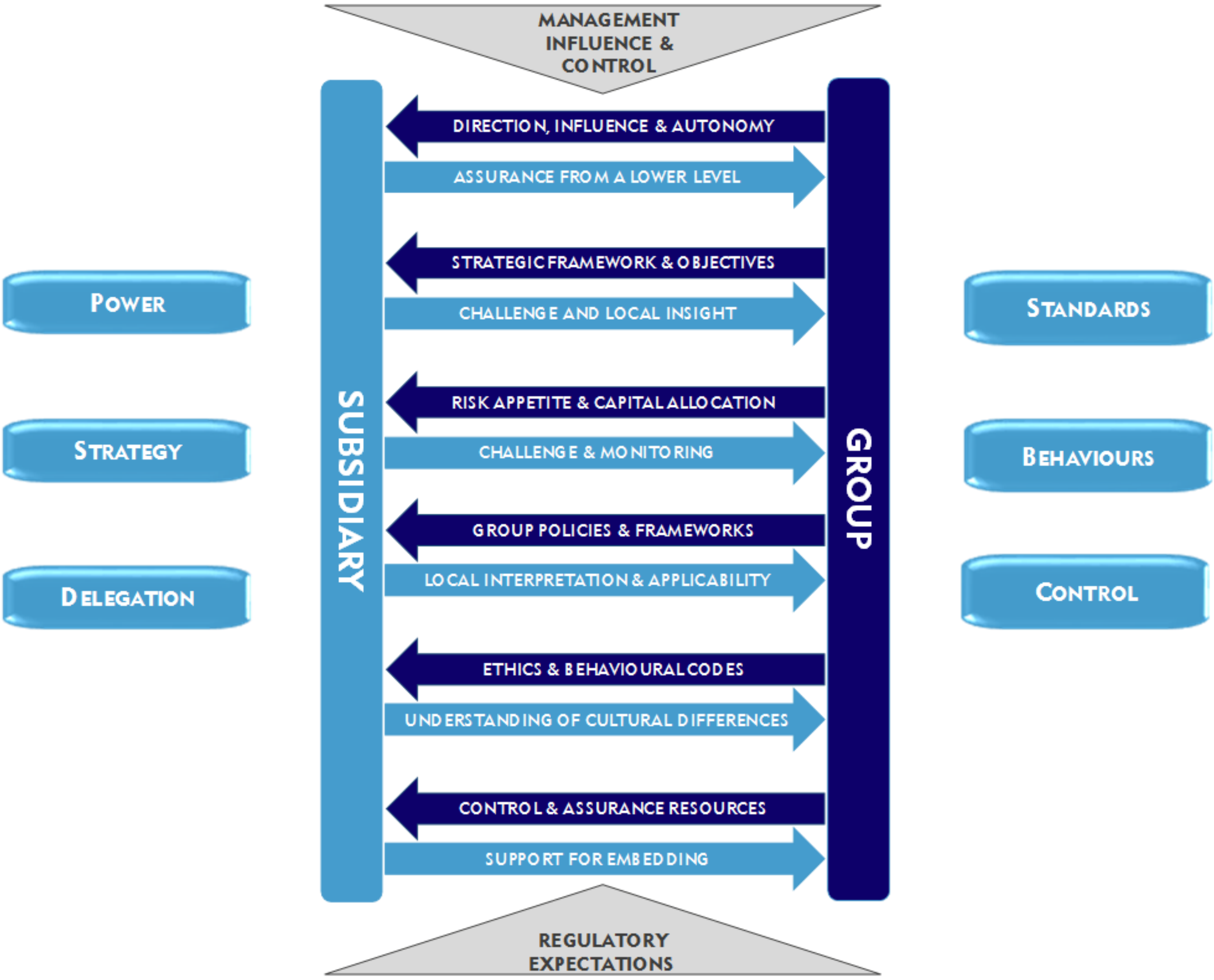
There is a sliding scale from those companies with subsidiary board control to those where governance is through the management line. At one end, you may have a holding company with a dividend-based relationship centred around targets and payment, while at the other end you may have a fully-integrated group with statutory boards as a bolt-on. If you lie somewhere in between these extremes, things can get messy – examples perhaps include regulated businesses, JVs, merged entities, tax-driven structures, public minority holdings and employee ownership. These may experience clashes between group management trying to exercise control, and the subsidiary board and/or management looking to steer the business and to meet their legal obligations. Add in regulators, and this can get even messier.



It's helpful to think carefully about your position on the scale, both from the perspective of management control and board engagement. Think about the flows in both directions – subsidiary up to group and group down to subsidiary, and see how this varies when viewed from different angles or in the context of different issues. Look at how the management structure works across the flows and, if it applies, how regulatory expectations cut across.

Framework for thinking this through

We suggest a framework which may help as a starting point – of course, it's not fully comprehensive and will need variation depending on your particular situation, but hopefully it is a good place to start.



Think about how to group the different types of flows, both from group to subsidiary and from subsidiary to group. Consider dimensions such as **power, strategy, delegation, standards, behaviours and control**. Of course, these flows will be complicated by management influence and regulatory expectations, and you should think about how each dimension is affected by where you sit on the spectrum.

Some examples of angles to assess

Together – not in isolation – think through…

SHARE STRUCTURE	Who are the "members"? What are the strategic objectives? Short-term or long-term? What's the law? Board contribution? Fit vs. management control?
PORTFOLIO STRATEGY	How does subsidiary fit in Group portfolio? (product, geographical, brand, capital, tax…)
STRATEGY	How strategy is formulated and communicated – the same applies to risk appetite
STAKEHOLDERS	Who else (locally?) does a subsidiary board have to consider?
REGULATORY DIFFERENCES	Group understanding of local requirements, risks and relationships
REMUNERATION	The fit with Group policies, the applicability locally, responsibility for how it's applied, meeting regulatory responsibilities
EXECUTIVE APPOINTMENTS	Who decides – and who is consulted when
TAX	Formulation and communication of Group tax strategy and policies; local factors
SHARED SERVICES (and Outsourced)	Assessing adequacy/performance vs. service standards
ASSURANCE & RISK MANAGEMENT	The reporting lines, the control over resources and coverage
COMFORT	Scope for using executive bodies as a source of assurance to non-executives
INFORMATION	For the subsidiary board and committees – getting relevant, timely information
REPORTING LINES	Non-executive – and independent? - fit with management matrix

The solution

We suggest starting from a high-level and then working down into the detail. It is important to apply common sense and acknowledge the competing pressures.

WORK OUT…

- Governance objectives and opportunities
- Where you sit – or want to sit – on the spectrum
- If you've got board structures…their role
- If you're driven by the management line of control…how does this form part of the governance framework – as a source of assurance and the fit with group governance structures?
- How do the governance bodies – non-executive and executive – fit together?

PUT TOGETHER THE FRAMEWORK

- A clear practical statement of role agreed with Group
- Think through the practical consequences from different angles, activities…ie what needs to get done
- Work out who does what: it's not all about what the subsidiary has to do – but also about what Group has to do
- Then do a check: can you tell a clear story of how it works?

MOVE ON TO THE DETAIL

- Terms of Reference, processes, information, appointments…
- Work out how you're going to make sure that…
    - the subsidiary board structures are effective
    - how far can you rely on them – or what opportunities exist to rely on them more

And remember, none of this should be done in isolation by the company secretaries. It is valuable to talk to people throughout the business to understand what will work best.

For those that don't know our online self-assessment tool Thinking Board® is very good at helping you create a picture of how well your governance is working.