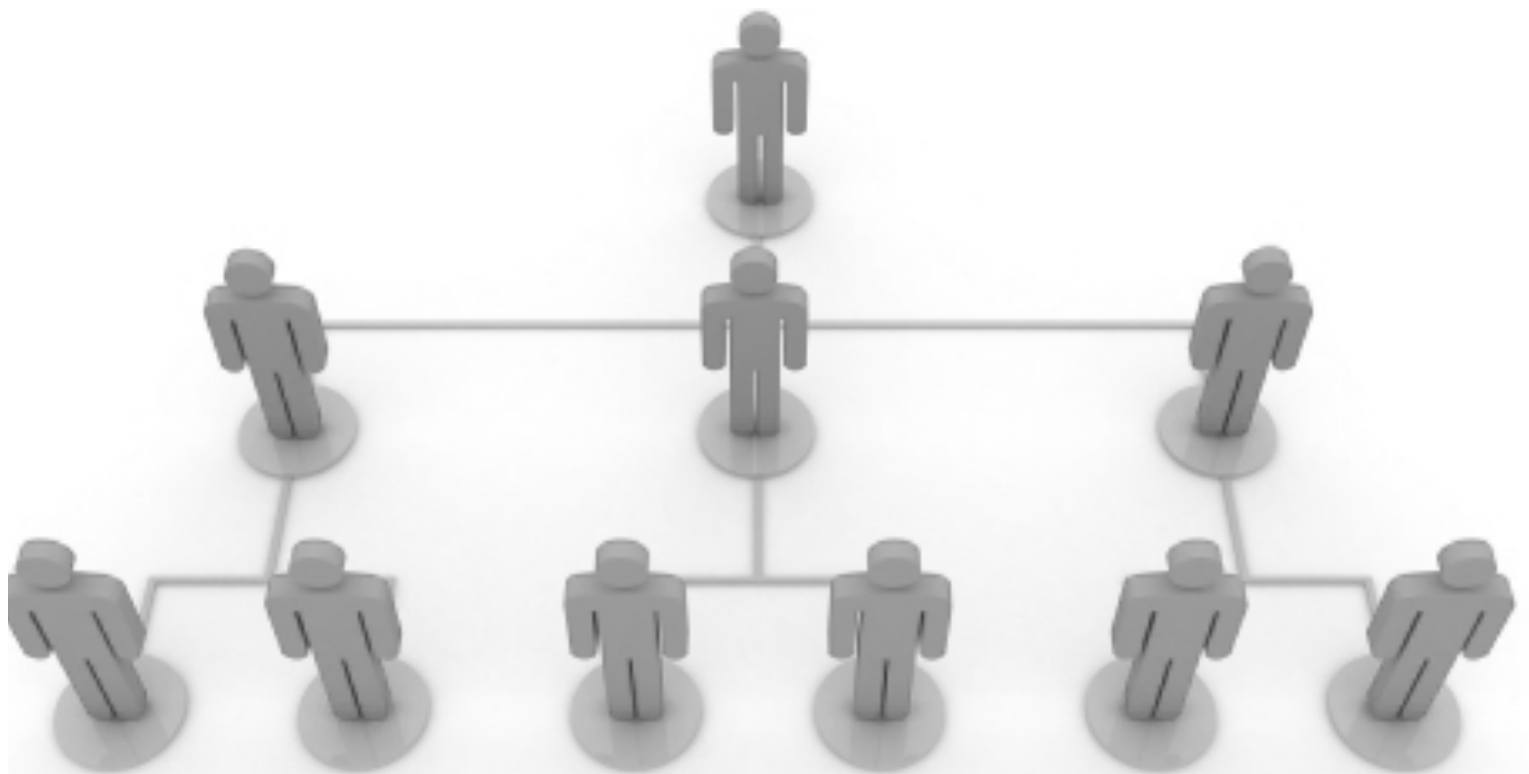




HARCOURT BOARDROOM RESOURCES

GROUP GOVERNANCE (PRACTICAL CONSIDERATIONS)



The management and oversight of large, international groups, with multiple subsidiaries is increasingly complex. It is no longer sufficient to structure the top company (“TopCo”) and expect the rest of the group to follow. As companies grow internationally and diversify, overcoming the challenges posed by group governance is at the heart maintaining a competitive position. An introduction to group and subsidiary governance is set out in “Group Governance – The Framework”. This paper summarizes some of the practical considerations the board and management of the TopCo must address:

1. The Role of TopCo functions and of local functions

In the initial stages of organic growth, the central functions will expand their remit to new activities or new areas. However, after a while, local functions will develop and take over some of the tasks assumed initially by the central functions. If a company expands by acquisition, the acquired company(ies) will generally have central functions of their own. In both cases, the relationship between the central functions of the TopCo and of the local functions of the subsidiaries will have to be (re)defined.

A totally centralized model will see the central functions of the TopCo continue to assume all the tasks and responsibilities within their remit, whilst the local functions are mere correspondents, reporting “strong-line” to the TopCo functions. A centralized model is akin to the way an operating company (industrial, technology, etc.) develops internationally and diversifies. This model rarely works in practice, if only because some of the subsidiaries will have local boards and shareholders or partners requesting that the local functions report to them first. The variety of local situations, whether regulatory or other, will also require local adaptation. As a result, local functions will often simply have a “dotted-line” relationship with TopCo central functions.

A totally decentralized model will see the TopCo functions reduced to their minimum, acting at best in an advisory role to the local functions, and at worst only as an inadequate central depository of information. The local functions will carry out all the tasks and responsibilities, and will report “strong-line” to their local management and board. A decentralized model is akin to the way many private-equity firms manage their portfolios of companies. This model also rarely works in practice, if only because the TopCo is often a listed company that has listed company requirements, for example around proper and timely disclosure of financial and other information, or must abide by compliance and other policies that are scrutinized by outside shareholders, all of which involve active local subsidiary cooperation.

For most groups, the answer will lie somewhere in between. Certain activities and processes will be directed and strongly managed by the TopCo central functions, particularly if the TopCo is a listed company - for example, financial reporting, or ethics and compliance. For other activities and processes, the TopCo central function will provide flexible frameworks and guidelines, and act as “advisers”, but the actual implementation will be left to the local functions – for example, HR policies or remuneration.

It is important that the TopCo board and management define those functions, processes and tasks that belong to the first category, and those that belong to the second. They must then obtain the buy-in and formal approval of the local boards and managements. Finally, everyone needs to ensure that the organization of each function reflects the role it is actually given in the group.

2. The role of subsidiary boards

All boards are created essentially equal in the eyes of the law. But in practice, subsidiary boards will have very different roles depending on the group and the circumstances.

Local partners will expect their local board to be fully empowered. They will generally understand and accept the needs of international groups, but will insist on clarity in the governance framework and that the jurisdiction over certain activities and processes be shared and prioritized.

The role of the local board is without doubt when the local subsidiary is publicly listed and has local shareholders. The difficulty will arise from the need to reconcile the legitimate needs of the TopCo, itself often publicly listed, and those of the local company. Even where there is a common agreement on principles, their understanding and application may vary widely.

Wholly owned subsidiaries also pose a challenge. Giving them a purely formal role weakens the oversight over local businesses. Giving them a more substantive role is often resisted by the TopCo central functions, unless the governance model of the group is clearly stated.

3. The nomination of subsidiary board members

TopCo representatives, called “nominees”, have to be appointed on all the subsidiary boards. Assuming that a subsidiary board is given a substantive role (either because of the group’s governance model, or because of local circumstances – partners, shareholders, regulation, etc.), the choice of nominees becomes important. The quality of the board discussions and decisions, and of the relationship with the TopCo, are critically dependent on who the nominees are and how they carry out their duties.

Unfortunately, relatively few groups pay enough attention to their nominees on subsidiary boards, to how they are appointed, and to how they carry out their responsibilities. Nominees will often be members of middle management, generally because of some relationship with (or understanding of) the subsidiary they are on the board of. They will be given little or no guidance or training, but assumed to know how to carry out their responsibilities. Rarely will any attention be given to who else sits on the local board, and what the challenges might be. Finally, the rules

about directors' fees will often be unclear – are they part of the nominees' compensation ? are they paid to the TopCo ? It is, therefore, hardly surprising that subsidiary boards end up running into problems.

TopCo management and boards should, on the contrary, pay close attention to who they appoint as nominees, give them appropriate (and regular) training, and make sure the terms and conditions of their responsibilities are well defined. The matter is sufficiently important for certain boards to ask that they be informed prior to the appointment, whilst other actually request a even more active role in the nomination process.

Groups might even want to go further, for example by specializing one senior member of the TopCo management team principally on nominee positions, or by requesting that the chair or vice-chair of subsidiary boards be reserved for a TopCo nominee. Consideration should also be given, where appropriate, to appointing as TopCo nominee an independent director from outside the group. In certain circumstances, an outsider representing the TopCo on a subsidiary board may be a better choice than an insider.

4. Documentation, manuals, procedures, etc.

“Board manuals”, “Group operating manuals/procedures” and “Function procedures/guidelines” (as they are generally called) are important, but in many cases of little help in fostering an effective group governance environment.

The problem is three-fold. First, these documents are often much too prescriptive and rarely read, so that nobody knows precisely what they contain. Second, as the group evolves, they are not kept up-to-date with changing circumstance in the group. And third, attempts by the TopCo to harmonize old or out-dated documents are often resisted by the local boards and managements, leading to endless and unproductive negotiations.

These problems arise from the first three issues raised above not being correctly dealt with. When the roles of the functions (central and local) and of the boards (TopCo and subsidiaries) are properly defined and agreed upon, and when the nominees (on subsidiary boards) are properly selected and appointed, the documentation aspects of group governance and of their necessary evolution become a lot easier. Documentation in itself will not clarify matters of substance that first needs to be defined and agreed.

In addition, there is benefit in keeping these documents short, and by having the Group Secretary organization keep an active oversight of all governance documentation.

5. The role of the Group Secretary

The Group Secretary organization plays an important role in ensuring an effective governance.

The first key role of the Group Secretary is to be the central depository of information regarding the governance of the group, from board and committee dates, to governance documentation.

The Group Secretary's role is also to manage the governance professionals in the group (board secretaries, general counsels, etc.) and work with them in a collaborative way to ensure that training, documentation, etc. are adapted to the circumstances of each subsidiary board, whilst ensuring that the objectives of effective group governance are maintained.

As on-line tools can facilitate many of these tasks, the Group Secretary organization need not be large. However, the choice of the Group Secretary is key. In addition, the Group Secretary will be in regular contact with TopCo board members and with local subsidiary chairman and directors, which requires a degree of seniority, experience and maturity not always widespread even in a senior management team.

6. The role of the Group and subsidiary chairmen

Not surprisingly, the chairmen of the group and of each local subsidiary also play an essential role in ensuring that the complexities of group governance do not become a cause for inefficiency, lack of competitiveness and reputational risk.

The role of the TopCo chairman sometimes boils down to ensuring that group governance is recognized as a strategic matter, and that decisions are made as to role of functions and role of boards (see above).

Most breakdowns occur in group governance because of lack of clarity as to objectives, weak processes and insufficient communication, more rarely because of hidden agendas and conflicting objectives. The TopCo chairman therefore has a role to play in ensuring that he or she keeps lines open with the local chairman, meets then regularly and fosters a culture of trust.

Finally, the TopCo chairman should also ensure that management, particularly the CEO, play an active role in group governance. There is no ‘best practice’ in this regard, as different methods will depend on circumstances and people. But generally, regular meetings of TopCo and local functions, or governance discussions and updates at TopCo or subsidiary board retreats/off-sites go along way towards making group governance more effective.

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