

Challenges for Subsidiary Boards

(published by CCH in *Across the Board*, February 2006)

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When we think about governance best practice, the paradigm in our minds is usually the widely held publicly listed company. However, boards of wholly or partly owned subsidiaries are likely to be far more numerous, and they face just as many, but quite different challenges. In this article we examine some of the characteristics of subsidiary boards and the nature of those special challenges.

We have already hinted at some of the features which will form part of the landscape in which the subsidiary board will be operating. Some subsidiaries are themselves listed; we won't look closely at that aspect. Many companies in Australia are subsidiaries of global parents – and therefore have boards comprised of both independent and shareholder-representative directors (often located overseas and infrequent attendees – which poses its own challenges for group dynamics). Subsidiaries of large, domestically-based holding companies often populate the boards of their subsidiaries with executives – raising issues of independence of views and conflicts of interest. And if the overseas parent in turn has a dual board structure, a management board and a supervisory board, the local board will have to learn how to cope with that division of responsibility.

The practice of including on the local board of a company with an overseas parent a mix of local independents and shareholder representatives can work very well. Firstly, shareholder directors are usually extremely knowledgeable about the industry and company. Complementing these skills, well selected independent directors can bring strong knowledge about local practice and custom, and also bring their networks and personal credibility. They are often the ones who can identify critical emerging issues and assess whether management strategies and proposals will be acceptable to local stakeholders. Finally, local directors not only fulfil statutory requirements for oversight but also provide ongoing, on-the-spot monitoring to keep management focussed and performing.

But these are all ideal notions. Unfortunately, all too often these potential strengths are not capitalised upon, and rather the weaknesses inherent in the structure tend to dominate. These weaknesses include: a lack of authority of local directors – often they have little or no say in critical matters such as CEO appointment, strategy, capital investment, and budget. Often tensions emerge as directors' obligations to the company come into conflict with at least some of the goals of the shareholder and at worst the board slips into factions. When this happens, local directors may decide they have no alternative but to focus on risk avoidance and conformance, and the board and the shareholder can end up sending quite mixed cultural signals to local management. Or even worse, a foreign parent, having lost confidence in the local management team (or simply deciding to change its strategic direction globally), can decide to sell out – often to the surprise of the local board.

For a subsidiary board to be effective over the long term, a number of practices should be in place:

- The accountability chain must be clear and unbroken. A clearly articulated board role and responsibilities, as well as details of those functions and matters reserved to the shareholder.
- Clear and regular lines of communication between shareholder and board. Typically this is achieved by the shareholder's representative(s) on the board itself.
- Regular sessions on strategy and planning with shareholder to ensure local board and management are acting consistently with those plans.
- The chair should be a local independent, rather than the shareholder's representative
- The statutory obligations on the local board must be well understood by the shareholder.
- If directors are used for 'stakeholder liaison', this role must be made absolutely clear along with their accountability.
- The independent directors should, at a minimum, contribute to the performance review of the CEO and senior management, as well as have input to the selection of new board members

None of these looks like, and none is, a rule. But the one issue of greatest difficulty is the selection of the CEO. Many would argue that the local board should choose its CEO, as if that is in all cases the role of the board. First, there are other cases where it is not – government boards, for example. Second, many directors arrive after a CEO was appointed, and quite often the CEO is the longest serving director – in what sense did the current board "select" that CEO? But finally, the vice is not in a board having a CEO it did not select – it would be in the board continuing with a CEO whom it did not respect. A subsidiary board which has lost confidence in the CEO must inform the parent, and either he/she, or they, must go.

Subsidiary boards will never look, nor should they act, like a stand-alone public company board. They simply are a different sort of beast. They should not try to be what they are not, but should acknowledge what they are – identify the strengths and weaknesses of the structure they are in, and implementing strategies to deal with the weaknesses. Justice Neville Owen succinctly encapsulated this common sense in the Report of the Inquiry into the collapse of HIH, where he says ““For me, the key to good corporate governance lies in substance, not form. It is about the way the directors of a company create and develop a model to fit the circumstances of that company and then test it periodically for its practical effectiveness.”

February 2006