

Subsidiary Governance

Overview

Subsidiary governance is a critical but often overlooked aspect of corporate governance. While traditional governance models focus on the parent entity, modern corporate structures—especially within multinational enterprises—rely heavily on subsidiaries. These subsidiaries vary widely in their roles, ranging from dormant entities to fully operational business units, and operate under different models influenced by regulatory frameworks across global jurisdictions. Effective subsidiary governance is essential for ensuring strategic alignment and managing day-to-day operations across these complex corporate structures.

What is a Subsidiary?

- **Definition:**
A subsidiary is a distinct legal entity within a larger corporate structure.
- **Formal Status:**
Subsidiaries can be dormant or fully operational.
- **Legal Standing:**
They are companies, just like any other, to which normal company law applies and have full legal standing, supported by a memorandum and articles of association.
- **Decision-Making Authority:**
Typically limited under their constitution, with some autonomy in day-to-day operations but little influence over overarching corporate strategy.
- **Director responsibilities:**
Subsidiary board directors have similar legal responsibilities to those of directors on the parent board.
- **Contribution to Corporate Structure:**
Subsidiaries play a key role in diversifying and strategically aligning the parent company's operations.

Models of Subsidiary Governance

1 Direct Control

- **Management:** Subsidiary directly managed by the parent.
- **Strengths:** Global efficiency, clear reporting lines.
- **Weaknesses:** Limited local market understanding, slower decision-making.

2 Dual Reporting

- **Management:** Local CEO reports to both local and parent boards.
- **Strengths:** Better local market insight, disciplined management.
- **Weaknesses:** Potential governance overlap, disempowered subsidiary.

3 Advisory Board

- **Management:** Local board provides advice without decision-making power.
- **Strengths:** Local insights, clear reporting.
- **Weaknesses:** Potential lack of local market understanding and added costs.

4 Local Board

- **Management:** Full control by a local board.
- **Strengths:** Strong local governance, flexibility.
- **Weaknesses:** Limited parent control, potential gaps in understanding.

It is important to customise these governance strategies to the specific needs and strategic objectives of each subsidiary. This tailored approach ensures that the subsidiary's activities are aligned with the parent company's overall objectives, contributing effectively to the broader corporate goals. By aligning the subsidiary's operations with the parent's mission, companies can achieve a cohesive and integrated governance framework that supports both local and global success.



Benefits of Robust Governance

Due to their varying levels of independence subsidiaries can function as mere administrative entities or operate as highly autonomous units. Nevertheless, effective governance requires a deep understanding of the cultural differences between the parent company and its subsidiaries, ensuring that these differences are managed appropriately. Additionally, both subsidiary and parent board members have legal responsibilities that can vary significantly depending on the jurisdiction, adding another layer of complexity to governance. Despite these challenges, well-governed subsidiaries can greatly benefit the parent company by contributing to its overall strategic objectives and enhancing organisational flexibility and responsiveness.

Principles and Strategies for Effective Governance

Effective governance requires a comprehensive approach that addresses various aspects of subsidiary management. Here are ten strategic practices to enhance governance effectiveness:

- 1 Risk and Opportunity Assessment:**
Assess governance-related risks and opportunities to enhance board decision-making.
- 2 Clarity in Governance Roles:**
Clearly define subsidiary governance roles and responsibilities to ensure effective governance.
- 3 Strategic Alignment:**
Align subsidiary objectives with the parent company's strategy to integrate activities with the parent's goals.
- 4 Board Structure Examination:**
Tailor the board composition to the subsidiary's needs to support its purpose.
- 5 Harmonised Processes:**
Align subsidiary processes with governance best practices to maintain consistent standards.
- 6 Control Implementation:**
Apply both hard and soft controls to ensure balanced governance.

- 7 Fair Incentives:**
Align incentives with ethical decision-making to encourage responsible behaviour.
- 8 Universal Incentives:**
Apply incentives uniformly to leadership teams to foster a cohesive culture.
- 9 Leadership as Role Models:**
Position leadership teams as cultural role models to reflect parent organisation values.
- 10 Shared Culture:**
Cultivate a shared culture across the organisation to reinforce governance principles.

In addition

- **Keep it Situational:**
Adapt governance practices to local contexts.
- **Keep it Strategic:**
Align subsidiary strategy with the parent's strategic plan.
- **Keep it Integrated:**
Ensure the board is composed of an integrated team.
- **Keep it Controlled:**
Implement comprehensive controls for all stakeholders.

Role of Governance Professionals

Governance professionals assist in managing legal entity risks and directors' responsibilities, and harmonising the organisation's response to international legislation.

G+C magazine:

<https://www.govcompmag.com/categories/topics/subsidiaries>

Blog:

<https://www.cgi.org.uk/blog/what-is-subsidiary-governance-intro-to-subsidiary-frameworks>

<https://www.cgi.org.uk/blog/what-are-the-biggest-risks-in-subsidiary-governance>