Dr. Helmut Maucher  
*An Interview with the Honorary Chairman of Nestlé*  
pages 06-09

Reflections on Gulf Corporate Governance  
*In-depth look at how the Gulf views Corporate Governance*  
pages 33-42

The Importance of Subsidiary Governance  
*Four perspectives on on the latest regional trend*  
pages 10-23
It is often a misconception that 'Governance' is something we can adopt or ignore. The reality is that we all do 'Governance', even in our personal lives. The question should be how well we do it.

The issue is that since the term 'corporate governance' was coined by Bob Tricker, in his book 'Corporate Governance', in 1984, it seems that everyone who has written about corporate governance has developed their own definition. Rather than clarifying what corporate governance is this has led to more and more confusion over what corporate governance means. It has also led to problems for well meaning multinational companies as they can find themselves trying to comply with many differing and sometimes conflicting laws, regulations, standards and codes of corporate governance across the many countries in which they operate.

The origin of the word ‘governance’ appears to be in Geoffrey Chaucer’s ‘The Canterbury Tales’ which was written at the end of the 14th century. In the Clerk’s Tale, the clerk is asked by the host to tell a merry tale. The clerk replies, that the host has the ‘governance over the company’ i.e. is in charge of the group, and so he will do as requested. Governance therefore appears to mean how a group of people are regulated or their behaviour controlled to achieve the optimum outcome. If we take this definition back into the corporate world it should mean effective leadership to create sustainable value whether this is for their shareholders or a wider group of stakeholders. In many parts of the world there is also now a growing expectation that this includes being a good corporate citizen.

This interpretation of corporate governance is far more than compliance with a set of laws, regulations, standards or codes which is what corporate governance in many countries seems to have become. It is about building an infrastructure to regulate and control behaviour within an organisation to create effective leadership and create sustainable value. This is difficult to accomplish in a single organisation in the case of subsidiary governance multinationals are looking to do it across a multitude of companies and countries.

Before I look at what multinationals should consider when developing good subsidiary governance I would like to tell two stories which highlight issues surrounding subsidiary governance.

The first involves a joint venture in sub-Saharan Africa between a multinational company and a local company involved in the tobacco industry. The Managing Director of the JV is an expat appointed by the multinational company. The JV is a registered company in the sub-Saharan African country and has a Board of Directors. The Managing Director received an instruction through the management line from the head office of the multinational to change the way tobacco was purchased from the out growers. The Managing Director implemented the instruction without consulting the Board of the JV. This action not only brought an end to the JV but also nearly destroyed the tobacco industry in the sub-Saharan Africa country where it was the main source of income for many people living in the country.

The second story involves a multinational company wanting to grant share awards to its senior managers across the globe. Due to a change in transfer pricing regulations to avoid the cost of the awards being taken into the books of the parent company, the Head Office Corporate Secretarial function was asked to organise for the Boards of each subsidiary company who had an individual eligible for an award to pass a resolution granting the award to that individual. It seemed a straightforward request. In practice it was anything but. The Head Office Corporate Secretarial function soon found that many of the subsidiary companies had active Board’s with non-executive directors on them who were not prepared due to their own corporate governance regulations to simply rubber stamp a request from head office. The individual’s performance did not stack up against comparator performance in the country, something that had not been taken into consideration in granting the global awards. This in turn led to HR issues for the multinational as expats did not want to take up positions in those countries where it was perceived to be difficult to get awards.

The lessons from both of these stories are:

Firstly, an assumption that an instruction from head office should be/would be followed without question.

Secondly, local managers following instructions from their regional line managers without consulting the local Board.

Thirdly, a lack of knowledge by the Head Office decision makers of local conditions and environment.

Fourthly, a lack of awareness and perhaps respect of local corporate governance requirements by the Head Office.

Another aspect to subsidiary governance is where a multinational purposely does not implement the level of
governance in its subsidiaries that it is required to do for its parent company. Again this can be evidenced in the activities of some subsidiaries of multinational companies in developing countries where enforcement of regulations is weak. The proliferation of electronic communication and news channels has meant that the reputations of some of these multinational companies are coming under threat as stakeholders perceive this behaviour as unacceptable and are taking action to vent their disapproval. Recently the South Africans introduced into their corporate governance regulations the requirement for all South African companies to practice the same level of governance in their subsidiaries outside of South African as they are required to do in South Africa.

The activities of subsidiaries are also leading to legal liability for parent companies. For example, European and US multinationals are struggling with the anti-bribery legislation that applies not just in their home country but also globally. How do they ensure that the same ethical standards required in their home country are applied wherever they operate.

Multinationals are learning the hard way, that a requirement in a Code of Ethics or a contract of employment to comply with laws and regulations is not enough to make a successful organisation and protect that company’s reputation. Multinational companies need to create/develop cultures of good governance at all levels within the organisation.

The million dollar question is how do they do this?

Good governance requires transparency, accountability, responsibility and fairness. It also requires reputational risk to be managed effectively. Multinationals who wish to practice good governance should therefore have systems and processes in place that ensure that:

1. Their organisation is open in all of their actions, relationships, processes and decision-making. Disclosure of information both within the organisation and externally to stakeholders should be timely and accurate on all material matters, including: the financial situation, performance, ownership and corporate governance.

2. Global training and networking events are held where they can get across to managers and staff what behaviours are acceptable. These activities help individuals to realise their value to the organisation as a whole, cross fertilize ideas, consider lessons learned and build relationships with their peers in other countries.
3. Policies are put in place requiring Boards at all levels to be held accountable for their decisions to key stakeholders, including shareholders.

4. Boards and senior managers are encouraged to consider key stakeholder views with justice and avoidance of bias or vested interests. The Board and management should apply fair practice in their dealings with stakeholders and adhere to the spirit not just the letter of all rules and regulations that govern the organization. The organization should provide effective redress for violations.

5. Both the members of Boards and senior management should understand what the responsibilities of the Board are in their jurisdiction and Boards should be encouraged to carry them out with honesty, probity and integrity. Organizations should ensure that procedures and structures are in place so as to minimize, or avoid completely, potential conflict of interests that could arise.

6. Good Board Practices are encouraged at all levels within the organization evidenced by well-structured Boards with the appropriate composition and mix of skills. The appropriate procedures should be in place to ensure that Boards perform efficiently.

7. A risk management framework is present enabling the organisation to identify, assess and mitigate risks throughout the organisation not just at the parent company level.

8. Key stakeholders (which includes shareholders) and their legitimate interests and expectations have been identifies at all levels throughout the organisation and that these are known.

9. All parts of the organisation act as a Good Corporate Citizens, behaving ethically, complying with all relevant laws, regulations, standards and codes as well as taking into consideration social and environmental issues relevant to the organisations operations.

10. Reward systems encourage good governance. Resources should also be made available to strengthen governance practices which help create value and ensure sustainability of the organization.

11. The organisation manages its Reputation and Reputational Risk. Reputation defines an organization as well as the individuals associated with that organization. Good practices ensure a good reputation. Bad practices can destroy a reputation overnight.

All the above should be carried out not as a checklist but in the spirit of making the organisation as a whole a better performing value creating entity.