EFFECTIVE CHAIRMANSHIP AT SUBSIDIARY COMPANIES

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Subsidiaries are a fact of life for virtually all companies - like the corporate form itself, they are ubiquitous. For a host of legal, regulatory, organizational and other reasons, subsidiaries are typically where the real operations of a company are housed – subsidiaries own the assets, employ most of the employees and execute the strategy. As separate legal entities, every subsidiary must have a board of directors, and each such board will have a chairman. This article explores the role of the chairman at subsidiary boards and how to optimize his or her effectiveness.

Subsidiary Board Structure and Decision-Making Authority

How to be an effective chairman of a subsidiary board depends on the role of the board of directors at that particular subsidiary. Local law typically requires that corporations establish a board of directors which is responsible for managing and directing the affairs of the corporation. Directors are required to fulfill fiduciary duties to act with due care, in good faith and in the best interests of the company. At the parent company level, the board is elected by the shareholders and it selects and provides oversight of management, which is responsible for the day-to-day running of the company. The parent company board may include inside and/or outside directors, with the proportions of each depending on the corporation's needs and applicable regulatory requirements.

The role of the board and what its composition should be become less clear-cut further down the chain in the corporate structure. *That said, ultimately, it is up to the parent company to determine what the role of the subsidiary board should be and who the subsidiary directors should be.* This is the reality. There are no right or wrong answers - the key is to ensure that the lines of authority and responsibility are clear, and that the subsidiary board is comprised of the right people, given its needs and responsibilities.

Role clarity can be accomplished with a delegation of authority that reflects who makes what decisions and what information needs to be reported up to whom and how often. There are countless permutations of how decision-making authority can be divided between the parent and subsidiary boards – and such authority may vary from subsidiary to subsidiary within a single corporate group. For example, the parent company of a wholly-owned subsidiary may want to retain complete strategic and financial control over the decisions made by the subsidiary board. Or the parent company may make the strategic decisions then step away to let the subsidiary board implement them with oversight by the parent board. Or the subsidiary board may have complete decision-making authority with respect to the activities of the subsidiary. Or the parent company may want veto rights over certain decisions relating to the subsidiary that rise above a materiality threshold. And so on.

The composition of a subsidiary board will depend on what the agreed role of that board is and whether and to what extent the parent thinks it would be helpful to have input from experienced outsiders. Non-executive directors can have special value for "closed" companies such as state-owned enterprises and family firms as they provide a way to bring in independent outside advice. Consultants can be hired to provide advice, but they typically work to a brief and may not be involved in implementation, whereas outside directors have advantages of continuity and commitment. Outside directors can be empowered to give objective advice on contentious issues such as strategy, succession and conflicts of interest,

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particularly where they are treated equally to other directors including those representing the parent company. For example, if the role of the subsidiary board is to carry out the decisions of the parent company (and not make its own decisions), a "management board" comprised entirely of members of the parent company's management team may be appropriate. If the parent wants input from outsiders, an "advisory board" could be useful as a first step - however, the best candidates may be harder to recruit into an advisory role (as opposed to a board seat with real decision-making authority). And once recruited, it may be difficult to retain advisory board members' enthusiasm and interest in a purely advisory role over a long period of time.

There can be great value in having true, empowered boards with at least some outside directors at the subsidiary level, provided this works for the company under its circumstances. An empowered board may be particularly beneficial where the subsidiary is operating in a complex industry that is outside the expertise of the parent. Other than the value of outside advice discussed above, following accepted good governance practices like having an empowered board can be greatly beneficial as the subsidiary deals with people inside and outside the organization such as employees, customers, suppliers, joint venture partners, regulators and other stakeholders who may be wondering "is this a real company?" Depending on the company's structure, its subsidiaries may be out in the world – and they do not operate in a vacuum. They need to be able to attract the best management teams available. Customers need to have confidence in the quality of their products and give them business over the long-term. Suppliers must be reliable and offer a good price. Regulators should give them the benefit of the doubt. In addition to selecting appropriate directors, the parent company can also take steps to professionalize the subsidiary board by implementing governance practices that are typical at parent company boards, such as limiting the number of boards a person can serve on and conducting rigorous and regular subsidiary board evaluations. The benefits of following good governance practices only increase when companies need to tap the outside markets for capital.

Although the benefits are myriad, there are burdens that come with establishing empowered subsidiary boards - some degree of control relinquishment by the parent, the need to recruit and compensate appropriate outside directors, some loss of nimbleness in decision-making and so on. Every company needs to decide for itself what it wants from each of its subsidiary boards and structure them accordingly. One size does not fit all.

Role and Responsibilities of the Subsidiary Chairman

An effective chairman is critical to an effective board. Sir Adrian Cadbury[1] summed up the crux of the issue as follows:

"*It all turns on chairman of subsidiary boards being able to retain the confidence of their own boards and those of their parent companies. It is a fine balance. There are hazards in having a subsidiary board which fails to make the local case as forcefully as it should and does not fulfil its role to act as an effective and independent source of advice to the parent board. The likely outcome would be an unnecessary degree of involvement by the parent company in the subsidiary company's affairs. Yet the more the subsidiary board acts as a true, independent board, the greater the chances of a clash of views. This is why so*

[1] Sir Adrian Cadbury, Corporate Governance and Chairmanship (2002 ed.) 193.

much depends on their chairmen. It is only by building up good personal contacts with the appropriate people in the parent company that chairmen of subsidiaries can earn their trust and enable them to appreciate the local point of view. It is the responsibility of parent companies to find subsidiary company chairmen who understand and accept their role, and then to keep in touch with them and give them the backing they need in a difficult task."

In a nutshell, the chairman of a subsidiary board serves a vital role in liaising and communicating up and down and sideways, inside and outside the corporate group - from the subsidiary board up to the parent, down to management and sideways to outsiders dealing with the subsidiary. This will be the case no matter how the subsidiary board is structured. How he or she performs that role and the exact nature of his or her responsibilities will be for the parent company as sole or primary shareholder to determine.

It is becoming increasingly common to memorialize the roles and responsibilities of the chairman in a written document. This list should be tailored to what is expected of the chairman of the particular subsidiary and could include any or all of the following practical steps.

- Ascertain from the parent company what the goals of the subsidiary are and how to communicate them within and outside the company as appropriate - how does the parent company define "success" at the subsidiary level? This will help the subsidiary board to make decisions that are in the best interests of the company and its shareholder(s);

- Work with management at the parent and subsidiary to develop the board's calendar and agenda, and prioritize issues appropriately. Resolve tensions that might arise between parent and subsidiary management and the subsidiary board as to what those agenda items should be;

- Determine what information the board will need to fulfill its responsibilities and liaise with parent and subsidiary management and advisors as necessary to prepare relevant, succinct and timely materials;

- Communicate with shareholder representatives on the subsidiary board in advance of meetings to understand parent company positions and sensitivities;

- Ensure that board meeting time allows sufficient time for discussion. Management presentations should be distributed in advance to maximize board deliberation time;

- Preside over board meetings and ensure the board's decisions are made in a timely and considered way that enables the directors to fulfill their fiduciary duties. Keep the meeting to its agenda as far as possible but adjourn the meeting if more time is needed to discuss a particular issue. Directors should not be made to feel rushed or pressured to make a decision;

- Understand the board's dynamics and culture. Ensure that all directors are able to express their views. The most effective way to do this will depend on the personalities and size of the board. Some chairmen like to "go around the table" on issues to make sure everyone has "air time," but this approach can be unwieldy with a larger board and packed agenda;

- Manage tensions and disagreements between directors so as to move the board towards consensus decision-making wherever possible;

- Deal with inappropriate director behavior promptly. This may necessitate the chairman taking a director aside for a quiet word, arranging coaching or other action. Apply special sensitivity and discretion;

- Communicate as agreed with the parent company on issues that may arise between board meetings. Be prepared and willing to deliver hard messages that may not meet the parent's expectations;

- Work with the company secretary to ensure that draft board minutes accurately reflect what occurred at meetings including what decisions were made and what the action items are, and that draft minutes are circulated for review in a timely manner after meetings;

- Provide input into how board assessments should be conducted and otherwise help coordinate the assessment process; and

- Ensure there is a good complement of skills on the board.

Selecting a Subsidiary Chairman

Once the role and responsibilities of a subsidiary board chairman have been defined, the next step is to make sure the company has selected the right person for the job. The subsidiary chairman will typically be appointed by the parent company and should have the support of the other subsidiary directors. Depending on the company and the role of its board, the chairman could be a parent company representative or an outsider. The person needs to have the time to commit to the role, which can be very time-intensive, depending on the company and the extent of the parent's involvement in the subsidiary's board decision-making and/or operations. The subsidiary's CEO would not typically be a good choice as chairman, given the nature of and tensions inherent in the subsidiary board chairman role. Managing the board and its relationships to the parent, to the subsidiary's management, and to outside investors where they exist, is a separate job than operationally running the subsidiary.

The subsidiary board chairman should have leadership qualities that lend themselves to effective chairmanship. He or she should be a good listener and communicator, and have charisma and courage. He or she should also be a senior person who is trusted by the parent company and at the same time be forceful enough to present and press divergent views when necessary. While gravitas is important, be careful appointing people of influence in the subsidiary's local market as they may be seen in that market as being in charge of company operations instead of the parent. He or she must have or be able to acquire in short order a deep understanding of the company's business.

Conclusion

To be effective, the chairman of each subsidiary must have a complete understanding of the parent company's goals and be capable of executing them. The role of the chairman may vary in degrees, depending on the ownership structure and the role of the subsidiary board – which may change from time to time, given the company's changing circumstances. The role will be even more delicate and important at those subsidiaries with some outside ownership and will require more communication by the chairman at all levels - up, down and sideways. A separate dedicated chairman will, under most circumstances, be the most appropriate structure. Clarity as to the parent company's goals for the chairman and his or her responsibilities is critical and must be tailored to the individual company and its circumstances - one size will not fit all.