# Subsidiary Structure

## Implementing an effective governance and compliance regime can be challenging, however it is an essential function

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Amongst the various challenges which governance professionals can face, a significant one for many is the need to implement a strong and effective governance and compliance regime across a multitude of entities in numerous international jurisdictions. It is undoubtedly a time-consuming, resource-intensive and costly undertaking requiring constant watchfulness, attention to detail and experienced management. But it is a crucial function, serving several essential purposes.

Firstly, it ensures good compliance with diverse regimes and mitigates the risk that the business inadvertently falls foul of some requirement or other, with all the potential for legal, reputational and financial consequences associated with such failings. This primary responsibility may be considered the baseline function for the secretariat, but it is no simple feat to achieve. Governance teams co-ordinating compliance across a global group need to keep abreast of a constantly-evolving regulatory environment across different regions and countries, ensuring that plans and processes are in place to comply with existing requirements and prepare for forthcoming changes.

Of equal importance is the need to ensure that the governance standards and systems of control expected by the group board are rigorously and consistently applied across the organisation. Alignment of controls across a group, perhaps implemented through the mechanism of a global subsidiary governance framework which overlays local regulatory requirements with internal policies on matters such as principles for decision-making and appointments, provides assurance that corporate risks will be properly managed in all regions.

Such assurance is needed not just because of the potential implications for the organisation. For example, holding company directors may find themselves personally liable for bribery and corruption anywhere within the business notwithstanding that the nature of their control and influence may be wholly indirect. Naturally, group boards will therefore insist on receiving robust assurance on these points which are in many ways linked as much to culture and values as they are to procedural matters.

In addition, global entity management facilitates a wealth of internal reporting and data sharing necessary for preparing consolidated financial accounts, assessing tax issues and understanding the legal structure of the group. Ensuring that such information is accurate, up-to-date, reliable and can be produced upon demand is therefore another key facet of the corporate secretariat's responsibilities.

To meet these onerous requirements, one would normally expect extensive strategic planning to have been undertaken to ensure the ideal solution was in place. However, for many international groups, particularly those with long histories, the approach has built up over several years, often with systems which may have been inherited through merger and acquisition, bolted onto existing resources to create a working, but probably not optimum, approach.

## Two Potential Solutions

There are essentially two choices available to company secretaries tasked with masterminding international governance and compliance functions.

Firstly the role can be carried out in-house. Where a centralised model is used, the head office team will coordinate and consolidate records, using local colleagues and advisers to carry out day-to-day functions, including reporting, compliance, implementing governance structures and monitoring regulatory changes. With the availability of modern webhosted global entity management software and a robust network of internal practitioners and external advisers (for example law firms), this is certainly a feasible option and offers the benefit of having a 'single source of truth' within the business on its entities, ownership structure and officers.

Some in-house teams, however, still operate a decentralised model which, for many businesses has been the traditional solution. Under this system, individual divisions or regions are responsible for managing their own company secretarial and governance processes. Whilst this model can benefit from the clear understanding which local practitioners will have of requirements applicable within their own jurisdiction, the lack of a centralised database and universal policy framework can present challenges to a complex organisation in terms of record-keeping, reporting and group-wide assurance.

The second alternative, which an increasing number of global groups now choose, is to engage a single external provider with sufficient international reach and expertise to service all relevant jurisdictions. In many ways this feels like an ideal solution, switching day-to-day administration of this huge role and management of an often-complex network of advisers for the much less time-consuming task of managing one external provider. Opting for a single global adviser can be compatible with either a centralised or decentralised model, with instructions, oversight and relationship management conducted on either a global or local level, but with the added benefit for those currently relying on separate record-keeping systems of gaining that all-important 'single source of truth' in the form of a group-wide entity management portal.

## Planning the Project

Deciding whether to continue with an existing in-house model, possibly with some improvements, or to move to an external solution is a significant strategic choice. Thorough assessment of the options and then meticulous planning and management of any changes are essential. Like all significant and complex tasks, the best approach is to break down the project into smaller steps and decision-points.

Whilst the project can be carried out without external support, consideration should be given to engaging an independent adviser – one who will not themselves pitch for any on-going outsourcing work – to assist with the process and to provide additional experience and expertise. Unencumbered by in-house biases about how things are currently done, they will bring fresh insight and perspective and will provide an impartial view, knowledge of solutions seen elsewhere and dedicated resource that will not get diverted into other projects.

Before embarking on a review of external options, the project should kick-off with a discovery phase to assess the current in-house system – the extent, expertise, consistency and responsiveness of available resources, the perceived risks to governance and compliance standards, the reliability of management information and data, the full costs of in-house delivery and the degree to which managing a large in-house function distracts management from fulfilling more strategic governance, and ultimately value-adding, roles.

Identifying the strengths and weaknesses in the current set up will not only help crystalise thoughts about what an external service provider would need to deliver, but also enable alternative solutions to bolster in-house provision and plug existing gaps to be considered alongside the outsourcing option. It may be that the current approach is largely sound and that targeted enhancements to existing in-house resources and rationalisation of the network of existing advisers may sufficiently strengthen current processes to provide the assurance needed. But, particularly where that network has expanded piecemeal over a long period of time, a more strategic approach via the appointment of a single firm may offer a more cohesive solution.

If the latter seems likely to be the best option, or at least worth exploring, preparations will need to be made to conduct a tender exercise. It is important that the objectives for the tender are clear as these will inform the criteria used for assessing potential governance and compliance partners who can effectively meet the needs (current and future) of the business.

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## In-House Versus Outsourced

In assessing whether to continue to carry out the company secretarial and governance work in-house or outsource those functions, a key factor to consider is whether the loss of the direct control which in-house provision in theory provides could create problems. Consistently-applied standards can, however, be something of an illusion with an in-house model, with difficulties sometimes experienced in overriding the authority of a local director or in integrating acquired businesses. This can be less of an issue with an external provider which will be able point to the centrally-agreed contract terms and service standards with which they must abide, even where instructions and oversight are managed at a local level.

With an in-house function, the organisation's own culture can be an important feature in ensuring appropriate standards of compliance and behavioural expectations. If opting for an external provider, the company secretary will want to feel comfortable that they have chosen a provider which prioritises high standards, encourages compliance with the spirit as well as the letter of the law, and promotes transparency and openness if things go wrong, as they sometimes will.

Effective compliance of course relies not only on appropriate behaviours and best intentions to do the right thing, but also on possessing sufficient resources and expertise to deliver. The diversity of legal and regulatory requirements across a worldwide network of subsidiary companies, branches and other entities, makes knowledge of them all a considerable problem for a small team. Commonly, for an organisation without sufficient demand for specialist professionals in each jurisdiction, the compliance task or management of regional outsourcing can often be delegated to someone locally who is themselves fairly unfamiliar with the relevant requirements and may see their compliance role as an irritating add-on to their 'proper job'. External providers of sufficient size will have the edge in this respect. Servicing multiple clients across different jurisdictions means they have the scale to justify dedicated expertise for each country and can offer flexibility, cover for absence and access to practitioners within their wider team who can bring cross-functional expertise to bear when needed.

Responsiveness is another extremely important factor. Within an in-house function, a manager has complete control over their team's priorities, with the ability to pull colleagues off one task in order to focus on something of greater imperative and to juggle matters entirely based upon urgency to the business. As governance professionals will all know, pressing matters and intensive time-critical transactions can arise at very short notice. In an outsourced situation, whilst providers will generally do their best to accommodate individual requests, they may be reluctant to bind themselves to service level standards which may result in service to one client being prioritised to the detriment of another. But whilst the limits on a client's ability to demand urgent delivery might be a cause for concern, this should also be balanced against the capacity of a well-resourced service provider to throw additional qualified resources at a project or to cover gaps in a way which may just not be feasible for an in-house team, even with the option of temporary recruitment.

Finally, whilst it is key to bear in mind that any compromise to the primary responsibilities of the secretariat – robust delivery of compliance, governance and internal reporting – would represent a false economy and undermine the value of a competent governance function, cost effectiveness will always remain a key point in the evaluation of available options. This is, after all, at least a fully objective criterion against which to measure the in-house model against an outsourced scenario and, with constant pressure to constrain cost bases, any financial savings will be attractive.

The groundwork carried out in the discovery phase will enable cost comparisons to be carried out on a true like-for-like basis, starting with a thorough understanding of the efficiency of the current in-house model and taking a realistic view of the extent of continuing in-house resources that would still be needed to instruct, oversee and manage an external provider on an on-going basis. Equally, the full costs of outsourced options need to be understood. When a provider offers a fixed-price quote or hourly-rate based estimate, will that really cover everything or will there be additional charges due to restrictions on the agreed scope of standard services?

## Managing the Transition

At the very least the final outcome from this work should be a system which has been thoroughly reviewed and on which well thought out decisions have been taken to ensure that governance and compliance risks are minimised.

Whether the final decision is to outsource certain elements or to enhance in-house resources and processes, management of the transition to new arrangements is critical. Where outsourcing is the final decision, assurance will be required that a robust transition plan has been carefully devised and will be expertly managed. Clear project management responsibilities will need to be established but, with selection of an experienced external provider in the case of outsourcing, and internal oversight at an appropriate level in all cases, there is no reason why any changes should not be smoothly implemented. ■