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THE LONG VIEW

DO YOUR GROUP A FLAVOR

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If your idea of holiday reading is the Financial Times and the Wall Street Journal, one of the blockbuster stories of the summer was the failed attempt by the board of Ben & Jerry's to sue its parent company Unilever in an attempt to prevent Unilever from licensing the sale of their ice cream in the Israeli-occupied West Bank.

The thrust of Ben & Jerry's argument was that Unilever had breached the terms of the 2000 acquisition agreement which provided for Ben & Jerry's to maintain an independent board to safeguard its brand and reputation. This argument was supported by the majority of the members of the Ben & Jerry's board, but rejected by the US courts.

This case obviously raises some interesting issues about the respective responsibilities and duties of the directors of parent companies and their subsidiaries. But it also highlights the question of whether the parent and subsidiary's mission and purpose are aligned and how that impacts on their relationship.

Where a subsidiary has been spun out organically from the parent company you would probably expect them to share the same set of values. But that is not necessarily so in the case of subsidiaries that have been acquired.

Such subsidiaries may have very different stakeholders too.

An interesting recent example of this was the acquisition in September 2021 of Vectura, a company that specialises in the delivery of inhaled medicine, by the tobacco manufacturer Philip Morris.

The acquisition made strategic sense to Philip Morris, which has a target to generate more than half of its net revenues from smoke-free products by 2025, and as the offer was accepted it presumably also made sense to Vectura's board and shareholders, at least in financial terms.

That view was not shared by many of Vectura's stakeholders. Many health campaigners described the sale of Vectura to a tobacco manufacturer as unethical. They lobbied the company's shareholders not to accept the bid, called for regulators to intervene and some even threatened to boycott the company if the takeover went ahead.

Clearly there is a risk of lasting reputational damage to Vectura following its acquisition. In this case the board evidently considered that the potential benefits outweighed the risk. The Ben & Jerry's board, however, took a different view of the actions of Unilever, with its lawyers arguing in court that the company "has built its reputation on the authenticity of its social mission". The board appears to believe that it is selling its customers a set of values as much as it is a product.

These are two fairly extreme examples of the mission of the subsidiary or the values of its stakeholders being at odds with those of the parent company. But the same tension exists in less dramatic form in many groups of companies. For example, companies with overseas subsidiaries will sometimes inadvertently discover that the national culture of the country where a subsidiary operates is at odds with the parent company's approach.

This tension has always existed, but it is coming to the fore because regulators and investors increasingly expect boards to take account of the impact of their decisions on stakeholders and to act in a manner that will secure the long-term sustainability of the company and the world in which it operates.

What implication, if any, does this have for the division of responsibilities between the boards of parent companies and their subsidiaries?

While the legal duties of subsidiary board members are fairly clear in most countries – a study by OECD[1] in 2020 found that in the vast majority of jurisdictions these board members owe their duty of loyalty to the company not to the group – their actual responsibilities can vary greatly. While some will enjoy a fair degree of autonomy within the confines of the group's strategy and policies, others have much less delegated authority.

Boards are rightly being encouraged to engage with their stakeholders to a greater extent than previously. But if each of the constituent companies within a group has different set of stakeholders this can create challenges for the parent board. It operates at one remove from these stakeholders and may not be particularly well placed to assess and balance the impact on them when taking decisions.

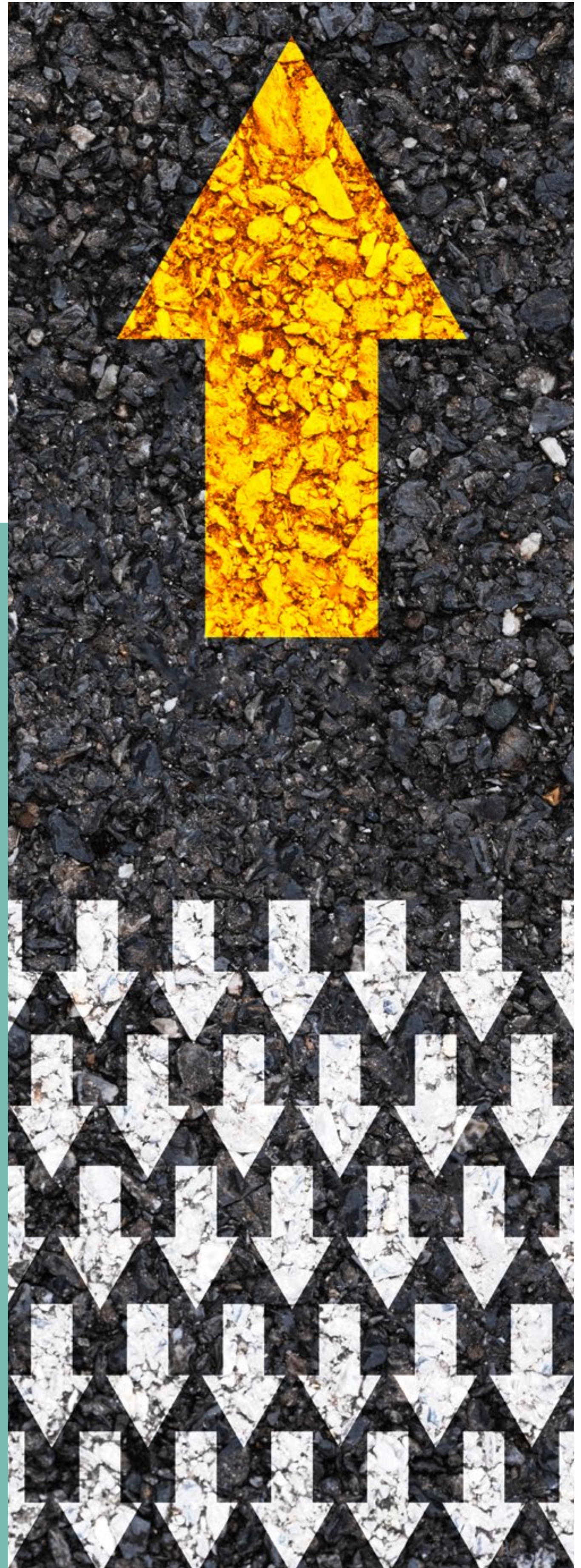
In my opinion there is a good argument for giving subsidiary boards the lead responsibility for engaging with their stakeholders as they are much closer to them. By doing so they can make sure that both their own decision-making and that of the parent company is better informed.

For similar reasons, group boards might want to consider whether it would be appropriate to give subsidiary boards greater autonomy for taking 'local' decisions.

1. *'Duties and Responsibilities of Boards in Company Groups'; OECD; 2020*

If doing so, it would also be appropriate to review the composition of these boards to ensure that they have sufficient members with relevant experience of the subsidiary's stakeholders and the markets in which they operate to enable the board to exercise its responsibilities effectively.

Delegating more responsibility to subsidiary boards does not reduce the need for oversight at group level – quite the opposite. It reinforces the need for a clear group governance framework that sets out where accountability rests, establishes common standards and ensures that there are adequate information flows between the subsidiary and parent.



Nestor Advisors has been advising corporate groups for decades, from developing group governance frameworks and policies, evaluating subsidiary boards, to supporting on implementation.

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