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Executive summary

The challenge

A company is a separate legal entity and, where a number of companies are linked with one another, they are referred to as a “group of companies” (or “group”), for the purposes of this paper.

A holding company can create a subsidiary to achieve certain strategic objectives. This is especially true in the case of wholly-owned subsidiaries. However, from a legal perspective, the board of directors of the subsidiary has authority to direct the affairs of the subsidiary.

In a group context, this gives rise to tension between the interests of the shareholder (in many cases, a sole or majority shareholder of the subsidiary – also referred to as the “holding company”) and the duty of directors of the subsidiary (often appointed by the shareholder/holding company) to take decisions in the best interest of the subsidiary.

In light of the above tension, it is not uncommon to find the following:

- Subsidiary companies exposing the group and holding company to increased risk;
- Inappropriate/excessive oversight by the holding company over subsidiaries;
- Dilution of accountability at the subsidiary board level; and
- Lack of strategic and governance alignment between the holding company and its subsidiaries.

Addressing the challenge

A fine balance is thus needed to ensure that there is alignment between the holding company’s strategic direction and the implementation of appropriate group governance. This must be done in a manner that recognises the role and duties of subsidiary companies’ directors and management, as well as the specific contexts within which they operate.

The King IV Report on Corporate Governance™ in South Africa 2016 ("King IV") emphasises the importance of developing a framework for group governance (“Framework”) to assist with managing this relationship.

A Framework for Group Governance

This paper provides guidance on the implementation of best practices in support of the King IV practice recommendations, including the nature and content of such a Framework, which is set out in Appendix 1.

In summary, it is recommended that a Framework should, as a minimum, address the following:

Role clarity:

- Leadership and governance: The holding company should determine priorities for achieving group objectives, and then provide direction on how the relationships and exercise of power within the group should be structured to achieve these. This includes direction on what should be centrally or locally driven.
- Ethical culture: The holding company has a special responsibility to shape the culture and values of the entire group.
- Strategy and performance: There should be clarity regarding both the accountability, and the process, for strategy development and target setting.

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1 The King IV Report on Corporate Governance for South Africa 2016. Copyright and trademarks are owned by the Institute of Directors in Southern Africa. The report can be accessed via the IoDSA website at: http://www.iodsa.co.za/?page=AboutKingIV.
Group corporate governance:

- Monitoring and oversight: The holding company should reach agreement with its subsidiaries regarding key governance outcomes and specific governance issues relevant or specific to the subsidiary.

- Group policies: There should be clarity about the nature and extent to which policies, structures and processes will be centralised or devolved to the subsidiary level, taking into account the risks a subsidiary represents, in light of its governance maturity and effectiveness.

Authority and reserved powers:

- Reserved powers: Matters that the holding company wishes to reserve for its decision-making (shareholder-reserved matters) should be clearly set out in the constitutive documents (memorandum of incorporation (“MOI”) or equivalent) of the subsidiary and should be limited to what is reasonably necessary.

Operating across jurisdictions:

- Global policies need to be modified for local use to ensure that they are locally relevant and compliant with local laws.

The impact of different legal structures on the implementation of a Framework is also discussed in this paper.

It is crucially important to bear in mind that there is no one-size-fits-all model. Consequently, an effective Framework has to be tailored to the relevant subsidiary's needs, as well as to the requirements of the holding company, by taking into account the nature and role of each of the entities within the group. Furthermore, the implementation of a Framework should be guided by the principle of proportionality and proper consideration of what is appropriate for each entity in the group.
1. Introduction

A company is a separate legal entity. However, in cases where a number of companies are linked to one another through direct or indirect shareholding, or where one company is a subsidiary of another, or where the same party directly or indirectly controls each of these companies, such arrangements are referred to as a “group of companies” (or “group”) for the purposes of this paper. It should be noted that a group of companies does not, as such, have a legal personality or legally recognised rights, and each company within the group retains its own separate legal personality.

The focus of this paper is on the role of the holding company as a shareholder and how it can, in that capacity, ensure effective governance of its subsidiaries/associated entities within the context of a group of companies.

While there has long been awareness of the importance of the relationship between a holding company and its subsidiaries, interest in it has intensified recently, in large part due to corporate scandals involving a holding company being exposed to risks at a subsidiary company level.

King IV emphasises the need for developing a Framework that provides the parameters within which relationships in a group of companies can be effectively managed in the interests of all concerned.

This paper will consider further guidance on the implementation of best practice, in support of the King IV practice recommendations regarding group governance.

While this paper is written with a particular focus on holding companies and subsidiaries operating in South Africa, it may serve as guidance for all companies operating in a multi-jurisdictional group context.

2. Current challenge

A holding company can create a subsidiary to achieve certain strategic objectives. This is especially true in the case of wholly-owned subsidiaries. Achieving those strategic objectives depends to a large extent on whether subsidiaries align themselves with the vision and goals of the holding company. However, from a legal perspective, only the board of directors of the subsidiary has authority to manage the affairs of the subsidiary. These directors are required by law to act in the interest of the entity of which they are directors.

In a group context this potentially gives rise to a tension between the interests of the shareholder (in many cases a sole shareholder of the subsidiary company – also referred to as the holding company) and the duty of subsidiary directors (appointed by the shareholder) to take decisions in the best interest of the subsidiary. The tension arises when those decisions would be in conflict with the strategic direction of the holding company.

As legitimate as the holding company’s concerns might be, imposing its will on the subsidiary without due regard for the role and duties of the subsidiary directors could expose those subsidiary directors to liability for failing to fulfil their duties as directors, while also attracting direct liability for the holding company.

Further, it is not uncommon to find holding companies being exposed to increased risk by their subsidiaries, particularly with regard to reputation and brand risk. On the flip side, subsidiaries may also fail to achieve their purpose within a group, due to inappropriate or excessive oversight by holding companies. This can also result in dilution of accountability when subsidiary boards become mere rubber stamps for holding company decisions.

There is thus a real danger of lack of alignment between the strategy and governance of holding companies vis-à-vis their subsidiaries.

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2 Principle 16 of King IV refers to the adoption of a stakeholder-inclusive approach that balances the needs, interests and legitimate expectations of material stakeholders in the best interest of the organisation over time. This principle is relevant in the context of a group of companies where both the holding company and the subsidiary could potentially be regarded as an important stakeholder of the other.
Therefore, a fine balance must be struck to ensure sufficient congruence between the holding company’s strategic direction and the implementation of appropriate policies and controls in its subsidiaries. This must, however, be achieved in a manner that at the same time recognises the roles and duties of subsidiary directors and management. A well-drafted Framework can assist in striking this delicate balance.

The challenges outlined here are heightened when a group of companies operates in multiple jurisdictions. Relatedly, the degree of complexity in the group structure itself will also affect how best practices in this regard ought to be implemented.

The matters raised above will be addressed in the next section of this paper. Best practice guidelines on group governance will also be provided.

3. Addressing the challenge: best practice guidelines

Best practice guidelines

A. A framework for Group Governance

[In support of King IV Principle 16, Practice Recommendations 11-12]

i. Subsidiaries need effective governance, but this needs to be managed within a Framework that is consistent with the principles and practices of good governance.

ii. The objective is to achieve balance, alignment and effective monitoring by the holding company, while respecting the roles and boundaries of the subsidiary and its directors. This respect of roles and boundaries limits the risk of liability for the holding company, the subsidiary and the respective directors.

In terms of King IV, the recommended practices regarding group governance require that the board of the holding company should assume responsibility for governance across the group. It exercises this responsibility by adopting a Framework that provides direction on how the relationship between the holding company and subsidiaries should be structured and managed.

In addressing this challenge and seeking to strike the proper balance, it is important to start with an understanding of the respective roles of the holding company and the subsidiary boards within a group of companies, having regard for the relevant legal framework.

This paper will, therefore, provide further guidance on the nature and content of such a Framework in the context of the following:

- Role clarity;
- Group corporate governance;
- Authority and reserved powers; and
- Operating across jurisdictions.

Although there might be other challenges that a group of companies may experience, the focus of this paper is on the above factors that are regarded as the key challenges.

3.1. Role clarity

Best practice guidelines

B. Legal and governance framework

[In support of King IV Principle 16, Practice Recommendations 11-12]

i. In South African law, every company, whether a holding company or a subsidiary, is regarded as a
separate legal entity with its own rights and obligations. In fulfilling his/her duties, a director of a company (including a subsidiary) is obliged to act in the best interest of the company on whose board s/he serves.

ii. Adopting a stakeholder-inclusive approach, as required by King IV and contemplated in South African law, means that the best interests of the company are not necessarily always equated to the best interests of shareholders. The legitimate and reasonable interests, needs and expectations of all material stakeholders must be taken into account.

C. Role of the holding company vis-à-vis the subsidiary
   [In support of King IV Principle 16, Practice Recommendation 16]

i. The holding company should determine priorities for achieving group objectives and then provide direction on how the relationships and exercise of power within the group should be structured in pursuit of these priorities. This includes direction on what should be centrally or locally driven. This may include:

   a. The alignment of strategy across the group, which may mean input into subsidiary business plans and budgets.
   b. The alignment of processes to manage key areas.
   c. Effective group processes and policies to regulate key matters.
   d. Involvement in the appointment of key staff members at the subsidiary.

ii. The process should allow for the subsidiary board to have effective input into group matters affecting the subsidiary.

3.1.1. Role of a holding company

It is important to bear in mind that the holding company may have different roles in relation to a subsidiary. The holding company may be a lender and, in that capacity, may, in terms of the contract (the loan agreements), contractually negotiate for whatever rights it may require, similar to any other lender. There may also be a supplier-customer relationship in which one entity provides certain services and/or products to the other. Such a relationship should be contractually governed on an arm's-length basis. Employees of the holding company may also have certain managerial roles of support to the subsidiary management.

Finally, the holding company has a role as a shareholder and, in that capacity, needs to ensure effective governance within the group as a whole. In its capacity as a shareholder, the holding company has the same rights as all other shareholders, and the subsidiary should thus treat the holding company on an equal footing with all other shareholders.

The holding company should consider what the priorities are for achieving group objectives. This may include:

- Setting the tone for ethical leadership and an ethical culture;
- Aligning the strategy across the group, which might entail giving input into subsidiary business plans and budgets;
- Enacting effective group processes and policies to regulate key matters;
- Getting involved in the appointment of key members of staff at subsidiary level;
- Considering what matters may need to be reserved for shareholder (holding company) approval; and
- Proportionality (i.e. adopting and scaling practices for what is suitable and appropriate for each particular entity) and the impact thereof on each subsidiary within the group. Mindful consideration of what is needed in a particular subsidiary is important, as there is no one-size-fits-all solution. This requires taking into account the nature, circumstances and objectives of each subsidiary.
3.1.2. Role of the subsidiary

Being required to act objectively and independently in the best interest of the subsidiary does not mean that directors on the boards of subsidiaries should disregard all involvement by the holding company.

In certain instances, effective collaboration with a holding company, including seeking alignment with the group objectives, may indeed be in the best interest of the subsidiary as well.

It is important to ensure that this collaborative relationship allows for the effective input of the subsidiary board in all subsidiary-related matters at holding company level, including, where appropriate, the adaptation of group processes and policies to accommodate subsidiary interests.

In exceptional cases, where prior consultation with the subsidiary on certain group governance matters may not have taken place, the implementation process in respect thereof should ensure that each subsidiary has the opportunity to motivate for a different, more appropriate, implementation in its particular case.

3.2. Group corporate governance

**Best practice guidelines**

**D. Group corporate governance**

*In support of King IV Principle 16: Practice Recommendations 14, 16, 17*

i. Corporate governance principles and practices, as recommended by King IV, should be proportionally applied across groups to ensure relevance and appropriateness for subsidiaries.

ii. The principle of proportionality means adopting and implementing practices that are relevant and appropriate for the particular entity, while taking into account the nature, role, circumstances and objectives of each entity within the group.

iii. The key governance outcomes and particular governance issues that are relevant to the subsidiary should be articulated and agreed upon between the holding company and the subsidiary in terms of a Framework.

iv. Some of the important issues that present common challenges, and that should be considered for inclusion in a Framework, include: ethical leadership and values and the management of ethics; strategy; corporate citizenship; information management; integrated reporting; and assurance. (Further information regarding the content of the Framework is set out in Appendix 1.)

v. The extent to which policies, structures and procedures are centralised or devolved to the subsidiary level should be clarified, taking into account the risks a subsidiary represents, as well as the maturity and effectiveness of its governance.

King IV defines corporate governance as the exercise of ethical and effective leadership by the governing body towards the achievement of the following governance outcomes:

- Ethical culture and effective leadership;
- Good performance: value creation in a sustainable manner;
- Effective control: adequate and effective controls with informed oversight; and
- Legitimacy: trust and confidence in the organisation by stakeholders and the communities in which it operates.

In order to achieve these governance outcomes, it is crucial that the holding company and each company in the group (i.e. the group as a whole) clearly articulate and agree on the expectations regarding governance.

The specific governance issues of importance to a group of companies will need to be determined by each group, and are likely to differ from group to group. The nature and circumstances of a particular entity –
especially its maturity in terms of ethics management, governance and internal controls — will largely determine what is of particular importance to that entity.

Having said that, there are some important issues that are common challenges in a group context. These are discussed below.

3.2.1. Ethical leadership, strategy and corporate citizenship

Integrated thinking is one of the underpinning philosophies of King IV and forms the foundation of the governance outcomes. In a group relationship, it is important for the holding company that the fundamental social, economic and environmental matters, including corporate citizenship, are adequately addressed throughout the group.

It is vital that leadership in each company within the group structure is committed to the same or sufficiently aligned integrated performance targets, ethical standards, and the governance of risk and ethics. For example, the tone and direction set by leaders for dealing with potential ethics risks — such as refusing the payment of facilitation fees — will go a long way toward establishing the required ethical culture across the group of companies.

Standardised training programmes across all entities within a group with regard to ethics and compliance may be appropriate in certain circumstances, and can contribute towards developing common standards of conduct and a shared ethical culture.

Certain areas of risk expose the entire group and not just the particular entity in which the risk arises. Examples of such risks include reputation, cybersecurity and the protection of information. For instance, insofar as ethics is concerned, where companies have a South African, United States or European Union presence, the negative impact of a subsidiary being involved in corrupt activities could have significant implications for the entire group, irrespective of where the affected subsidiary is located.

The complexities regarding corporate citizenship, as well as social and ethics issues, also increase when a group has entities that operate and are located across jurisdictions. This will be discussed further below.

3.2.2. Policies

There is a need for alignment of policies across an entire group. Such alignment can also prevent a duplication of effort regarding policy formulation. Subsidiary boards should therefore consider the suite of policies required by the holding company and adopt them, where appropriate, with or without amendment. It is crucial to acknowledge that subsidiary boards cannot replicate everything the holding company does. Once more the principle of proportionality should be applied — i.e. the mindful application of governance practices to the specific circumstances of the subsidiary in light of its nature, size and industry, as well as the local institutional and legal framework and operating environment. Proportionality requires an appropriate consideration of these matters by each company within the group.

In many groups, standardisation may be required to some extent, in which case it needs to be agreed on a group-wide basis to make sense. For example, standardisation with regard to remuneration, job grading, or executive and employee training allows not only for economies of scale, but also facilitates mobility within the group.

3.2.3. Information management

- Disclosure of Information

The fact that a company is operating within a group context does not necessarily mean that the information it accesses or holds can be shared throughout the group.\(^3\)

There should be clear policies and procedures in respect of the disclosure of information *internally* within a group to ensure the appropriate flow of information, particularly where the holding company and/or subsidiaries are publicly listed entities subject to strict regulation. This is of particular importance in periods

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3 Section 76(2) of the Companies Act of 2008 allows some flexibility regarding wholly-owned subsidiaries and the use of information, but this does not negate the caution highlighted.
of corporate or other similar actions, where information flow has to be strictly controlled and confidentially maintained to limit the risk of insider trading.

Each company within a group may need to specifically agree that information obtained by individual directors can be shared outside the particular company, but just within the group, with conditions attached to such disclosure. The challenge in this regard is even greater when dealing with subsidiaries that are not wholly-owned, as will be discussed below.

Having individuals serve on more than one board within a group structure could also lead to situations where conflicts of interest arise, and effective management thereof is thus needed. This may mean that certain directors may need to be excluded from receiving information that would compromise their position vis-à-vis other companies in the group.

Where a holding company is listed, it is necessary to ensure that access to information within the group which could be considered price-sensitive is controlled as required by applicable listing requirements and legislation.

Considering that most stock exchanges require that all shareholders of the same class of shares be treated equally, a holding company should not take advantage of access to material information about its subsidiaries that other shareholders are not be privy to. This should be carefully managed. One solution is to have a clear policy that prohibits the holding company from trading in the subsidiary company’s shares for as long as it has access to information and management reports that are not available to other shareholders.

- **Information technology ("IT") and the protection of information**

  A number of jurisdictions have implemented laws and regulations for the protection of third parties’ personal information. The absence of adequate systems and processes of control could render the holding company and other companies in the group liable, even if a transgression occurred only in one subsidiary.

  The issue of cybersecurity, is crucially important as an IT-system breach in one entity could allow access to the information and systems of the entire group where these systems are shared. Therefore, steps need to be taken to ensure that these matters are well governed and managed across the group of companies.

3.2.4. Integrated reporting

Principle 5 of King IV states that “reports need to be issued to enable stakeholders to make an informed assessment of the performance of the organisation”.

It is important that the Framework provides clarity on the process for external reporting, especially in terms of timing. Where a holding company or its subsidiary is a listed company, the coordination of reporting schedules and disclosures is vital.

Furthermore, there should be alignment across the group on the approach to Integrated Reporting, to ensure that the final document to shareholders is useful and transparent. This will involve having a shared understanding of what constitutes material information and agreeing on the appropriate scope and boundary of the report. Naturally, information on the manner in which the group as a whole is governed – holding company vis-à-vis subsidiaries – should be included. An efficient and robust process of accountability for the Integrated Report must also be established, and this includes the use of information provided by subsidiaries.

3.2.5. External audit

In some circumstances, an auditor (the group engagement partner) might involve other auditors (the component auditor) to audit certain business activities or entities which will be included in the group financial statements. These components may sometimes operate in different jurisdictions.

The process of assurance, and particularly the role and appointment of external auditors, is becoming an area that requires specific attention. In some of the recent corporate scandals, notably in the Steinhoff
case⁴, the roles of the holding company and subsidiary auditors have been put into sharp focus, especially since the group included entities across various jurisdictions and different auditors who were not always within the same network. The question that arises is whether the group should appoint auditors from the same network across the group, irrespective of whether or not it is in the same jurisdiction, or whether the appointment of different audit firms within a jurisdiction, or audit firms from different networks across jurisdictions, might dilute the assurance that the group auditor (the group engagement partner) provides.

Either model could work, and each comes with its own practical challenges. However, the appointment of different auditors to audit components of the group should not adversely affect the assurance provided on the group financial statements by the group auditor.

Where the same audit firm performs the entire group audit, the knowledge and understanding of the entire group and the audit work performed are useful advantages, and these provide the group auditor with comfort to accept responsibility for the audit opinion on the group financial statements. Where the group auditor does not audit all the components of the group, s/he must perform additional procedures on material components to accept full responsibility for the assurance provided on the group financial statements. These additional procedures include that the group auditor communicates with the component auditor, directs them to perform sufficient audit work on the component, and monitors whether such work has been performed to the expected standards. Professional scepticism must be applied by the group auditor when evaluating the work of the component auditor in forming the opinion on the group financial statements.

In terms of auditing standards requirements, prior to December 2009, International Standard on Auditing⁵ (ISA) 600, Using the Work of Another Auditor, included a section on the division of responsibility that addressed this issue as follows:

"While compliance with the guidance in the preceding paragraphs is considered desirable, the local regulations of some countries permit a principal auditor to base the audit opinion on the financial statements taken as a whole solely upon the report of another auditor regarding the audit of one or more components. When the principal auditor does so, the principal auditor’s report should state this fact clearly and should indicate the magnitude of the portion of the financial statements audited by the other auditor."

However, this is no longer included in ISA 600 and the principal auditor (now referred to as the group engagement partner) has to accept full responsibility for the group audit.

Directors, and especially the audit committee, should display healthy scepticism and not accept information without questioning its credibility in circumstances where reasonable enquiry is necessary.

It is important to ensure that there is clarity on the process of appointment, the scope of the engagement of each auditor, and the manner in which information is shared and exchanged among the respective auditors.

The legislation regarding the appointment and rotation of auditors, especially mandatory audit firm rotation, may differ where the group operates in different jurisdictions, and this should be taken into consideration in the Framework.

3.3. Authority and reserved powers

King IV (Part 5.5) recommends that the board of a holding company ensure that the Framework recognises each subsidiary within the group as a separate and independent juristic person to whom that

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⁴ Steinhoff International Holdings NV is an American international furniture and household goods retail holding company that is dual listed in both Germany and South Africa. On 6 December 2017, Steinhoff's CEO, Markus Jooste, resigned after Steinhoff's auditors refused to sign off on the audited financials as a result of reported accounting irregularities in its accounts, causing Steinhoff’s share price to plummet. In December 2017, the Standing Committee on Finance of the Parliament of the Republic of South Africa condemned Steinhoff and called for investigations of the company by regulatory bodies including the Financial Services Board (FSB) and the South African Reserve Bank (SARB). Source: https://www.businesslive.co.za/rdm/business/2018-06-15-the-steinhoff-saga-part-one-the-making-of-a-corporate-giant/

⁵ ISA 600, Special Considerations – Audits of Group Financial Statements (including the work of component auditors), Section 18. The ISA was adopted in January 2005 for use by auditors in South Africa.
subsidiary’s directors owe fiduciary duties. It is only possible to give proper effect to this recommendation if the subsidiary’s board of directors is given adequate authority to be in effective control of the affairs and business of the subsidiary.

**Best practice guidelines**

**E. Legal and governance framework**

[In support of King IV Principle 16, Practice Recommendations 11-12, 16]

i. Matters that the holding company wishes to reserve for its decision-making (shareholder-reserved matters) should be clearly set out in the subsidiary’s constitutive documents (MOI or equivalent).

ii. The shareholder-reserved matters should be limited to what is reasonably necessary, considering the balance of interests required.

iii. The board of the subsidiary should be consulted regarding the determination of the shareholder-reserved matters.

iv. In instances where the subsidiary board delegates authority to a holding company committee, it should be understood that the holding company committee acts in terms of that delegation and not in its role as a shareholder, and should account to the subsidiary board in this regard. The directors of the subsidiary should integrate the functioning of such a committee into the work of the subsidiary board.

In a group of companies, the formal *Delegation of Authority Framework* approved by the board of directors of the holding company often incorporates the ‘rules of engagement’ as far as a subsidiary in the group is concerned.

It is not uncommon to find a subsidiary delegating authority to the committees of the board of the holding company regarding, for example, investments over a particular threshold. A holding company may also create committees at the holding company level to serve as committees for the both the holding company and its subsidiaries (for example, a Social and Ethics Committee or an Audit Committee).

It is, however, important to note that the board of a holding company is not in effect ‘delegating’ any functions to the board of directors of a subsidiary company, as the board of the subsidiary has the legal authority to direct the business and affairs of the subsidiary.

This does not mean that the holding company, in its capacity as a shareholder of the subsidiary, is not afforded any rights when it comes to the management of the business and affairs of a subsidiary company. In addition to the Companies Act, No. 71 of 2008 (“the Act”) requiring approval by shareholders in certain instances, shareholders could potentially negotiate additional approval powers by including a list of other matters that would require shareholders’ approval. These are commonly referred to as shareholder-reserved matters in the MOI of the subsidiary or in a shareholders’ agreement.

Where such limitation on the board of the subsidiary is imposed (whether by the Act or the MOI), the processes and procedures related to such limitations should be clearly spelled out and closely followed. Furthermore, provision should be made for appropriate involvement of the board of the subsidiary company in the actual decision-making process. This will provide the board of the subsidiary with the opportunity to properly apply its mind to the matter and make a recommendation to the board of the holding company regarding what it believes is in the best interest of the subsidiary.

The limitation on the authority of a subsidiary board should also apply to what is reasonably necessary. The holding company’s leadership should, therefore, be mindful of the fact that should they ‘assume the

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6 In South African law, the MOI takes precedence over the shareholders’ agreement in the event of a conflict between the provisions of these two documents. In addition, limitation of the authority of directors in addition to that imposed by law can only be legally enforced if contained in the MOI.
management’ of the subsidiary, this could expose the holding company and the subsidiary boards to liability. This is the case in common law jurisdictions, such as South Africa, and may be legislated in other jurisdictions as well. For example, in Rwanda, an amendment to the insolvency legislation makes a company related to the company in liquidation liable for its debts if it is found (inter alia) to have taken part in the management of the company in liquidation.

A board of directors of a subsidiary company should never ‘abdicate’ its duties and responsibilities, even if under the instructions of the shareholder, as it could be regarded as having failed in its duties towards the company. This could not only put the holding company and its directors at risk by being held directly accountable for the decisions made in the subsidiary due to their involvement, but could also potentially lead to the directors of the subsidiary being held personally liable for harm caused by their failure to govern the company.

3.4. Operating across jurisdictions

When operating in different jurisdictions, legal, institutional and regulatory frameworks often differ from country to country. This can seriously complicate the effort to adhere to all applicable requirements. In addition, the different commercial and market environments may require different marketing and commercial strategies.

There is no discretion when legal compliance is at stake. The laws of any particular country simply need to be adhered to by those operating in that country. The biggest risk in this context is not so much that a subsidiary company may contravene local laws, as the local board and company would be held liable. The more serious risk is where activities by a subsidiary, which may be lawful in terms of local legislation, expose the holding company to liability because they contravene a law or requirement to which the holding company is subject. For example, a holding company may be listed in a jurisdiction subject to various obligations in terms of sanctioned countries. These obligations may not have any direct application to a subsidiary operating in another country, but could make the holding company liable for the subsidiary’s action.

Best practice guidelines

F. Operating across jurisdictions

i. Global policies need to be modified for local use to ensure that these are locally relevant and, most importantly, that they are in adherence with local laws.

ii. A Framework should make it clear that any group requirements will be applicable only insofar as they do not conflict with local laws.

iii. All companies in the group should apply the highest standard of conduct that is applied by the group generally, especially regarding social and ethical conduct.

iv. Social and ethics issues

The local organisation needs to be relevant to the market within which it operates. Therefore, the holding company and the subsidiary should ensure that the application of key global strategies and policies is aligned with the imperatives of the local context on issues such as:

- Appointment of expatriate personnel;
- Recruitment and remuneration;
- Meaningful investment in skills development;
- Composition of governance structures;
- Sourcing and supply chains; and
- Setting up of Social and Ethics Committees.

Where a subsidiary operates in an environment with less stringent regulatory compliance than that of the holding company’s operating environment, actions by such a subsidiary (which may be legal in the host
country, but illegal in the holding company’s jurisdiction) could potentially expose the holding company to liability in instances where the offence could be imputed to the holding company. For example, the more stringent bribery legislation in the United Kingdom ("UK"), as well as in South Africa, have extra-territorial reach, and could therefore hold a South African or UK citizen liable for a contravention in a jurisdiction outside of South Africa or the UK. Even if the holding company could not be held legally liable, the reputational harm still could have a significant negative impact on the company’s brand.

The Framework should therefore ensure that issues related to legal and regulatory differences among different countries in which the group operates are appropriately addressed.

3.4.1. Corporate citizenship and social and ethics issues

When operating in different jurisdictions, care should be taken not to compromise organisational values by engaging in practices that might be acceptable in one jurisdiction, but unacceptable in another. The highest agreed standard in the group should be applied by each company in the group, irrespective of where they operate.

In South Africa, there are specific requirements regarding transformation, Broad-Based Black Economic Empowerment ("B-BBEE"), mandatory Social and Ethics Committees, and responsible corporate citizenship that may not be relevant in other jurisdictions. Similar issues arise for companies operating in African and other developing markets, where there is also an emphasis on indigenisation programmes (similar to B-BBEE in South Africa) and expectations of access to basic services by the majority of the population.

In such developing countries, social impact risk is as important to manage and report on as operational or financial risk. A company’s lack of commitment to, and engagement with, issues of gender, race, pay parity, social cohesion, human rights and inclusivity could directly result in fines, black-listing or consumer activism. This could affect the group’s reputation and brand as well as its ‘licence to operate’, which is granted by its stakeholders.

These social and ethical issues could potentially result in tensions between the holding company and its subsidiaries, especially where standardisation of practices and policies is required across the group.

Therefore, there should be effective alignment and collaboration between a holding company and its subsidiaries regarding issues such as:

- Human resources and recruitment policies: Will the need for employment equity or indigenisation allow for a departure from global policies?; and how will this affect the appointment of expatriate personnel?
- Composition of governance structures: How and to what extent will local requirements regarding transformation, diversity, gender and racial equity be balanced with the need to appoint holding company representatives to key positions?
- Sourcing and supply chain policies and practices: To what extent will local requirements for affirmative procurement (such as B-BBEE) allow for deviation from global policies?
- Social and Ethics Committees: Should such committees be established in other group companies in jurisdictions where no such requirement exists?
- Social and ethics standards: What standards should be adhered to regardless of local requirements?

It is crucially important to ensure that social and ethics issues are managed consistently and effectively across the group.

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7 For example, if a B-BBEE shareholder in a company is not allowed to be appropriately involved in the business, it could potentially be classified as “fronting” (i.e. having a B-BBEE partner as a front to circumvent statutory requirements). This could not only impact the company’s B-BBEE score, but may also be a criminal offence.
4. Impact of group governance structure on the implementation of best practice

Best practice guidelines

G. Impact of different group structures
[In support of King IV Principle 16, Practice Recommendations 11-12, 16]

50% Joint Venture ("JV")

i. The two holding companies should engage with each other and agree on how the subsidiary will be governed, and how the guidance provided in this paper will be applied.

Minority shareholder

ii. As with the 50% JV model, there still needs to be engagement among the various shareholders regarding the operations and governance of the subsidiary company.

iii. Special care must be taken to ensure that a minority shareholder is not being prejudiced for the benefit of the majority and/or other minority shareholders.

Non-Profit Organisation ("NPO")/Non-Profit Company ("NPC")

iv. Noting its unique challenges as an NPO/NPC in a group of companies, the Framework should determine the process in terms of which the strategy for the subsidiary of a not-for-profit holding company will be developed and approved, as well as the principles and processes that will inform the development of commercial policies.

v. Care should be taken in considering and establishing the governance framework for, and the relationship between, a non-profit holding company and its subsidiary so as not to compromise the tax status of the non-profit entity.

vi. Where a for-profit company creates an NPO/NPC, the application of the holding company requirements and policies should be considered, while taking into account the proportionality and the particular context within which an NPO/NPC operates.

Public-Private Partnership ("PPP")

vii. Relevant public-sector laws, policies, governance and operational issues that may need to take precedence in the PPP should be identified. Furthermore, consideration should be given to how the applicable framework for group governance in the private company group may have to be adjusted. There needs to be an understanding of the possible risks that may result from any deviations from the Framework. The extent to which public-sector requirements can be limited by the PPP agreement should also be considered.
This section will consider whether, and to what extent, group governance needs to be adjusted when dealing with different kinds of entities or structures.

4.1. 50% Joint Venture

Joint venture structures will be regulated primarily by an appropriate JV agreement and/or shareholders’ agreement providing, inter alia, for the rights of both parties in relation to key aspects of the JV or the relationship.\(^8\)

In an incorporated JV (i.e. where a JV company has been formed), each of the shareholders (i.e. each holding company) needs to agree, as part of the JV or shareholders’ agreement, on how the affairs of the subsidiary will be managed. In particular, the agreement should provide for the manner in which key strategies, policies, governance processes, key appointments and structures will be established and managed.\(^9\)

The main issue to deal with in this structure is how the two ‘holding’ companies engage with one another and align on what gets proposed for approval to the subsidiary board – or whether the subsidiary board is allowed the flexibility to determine these choices.

It should be noted that, in terms of South African law, the newly-formed entity could be regarded as a subsidiary of both holding companies.

4.2. Company with minority shareholders

As with the 50% JV model, there still needs to be engagement between the majority and minority shareholders regarding the operation and governance of the entity in which these shareholders have invested. The same principles apply as with a wholly-owned subsidiary, but there needs to be a specific discussion between the various shareholders to ensure from the outset that the relevant agreements provide clarity on operational and governance matters.

In addition, as the holding company strategy and policies are considered by the subsidiary board, special care must be taken to ensure that the minority shareholder or other shareholders are not being prejudiced for the benefit of others. The unfair discrimination or treatment of shareholders, whether majority or minority, should be avoided.

4.3. Non-Profit Organisation (“NPO”) and Non-Profit Company (“NPC”)

An NPO or NPC may hold interests in subsidiary companies and may also need to consider the issue of group governance. There are unique challenges for a Framework regarding having an NPO/NPC as the shareholder or holding entity.

It should be noted that an NPO could be an NPC, a trust or a voluntary association, each with its unique regulatory universe. In this section, reference is made to an NPO, which could be any of the aforementioned legal structures.

First, in the non-profit sector, entities may be public benefit organisations that enjoy a tax-exempt status. The subsidiaries could be for-profit companies and one of the key considerations in managing the group relationship will be to ensure that the tax-exempt status of the holding entity is not compromised.

\(^8\) In certain instances, an unincorporated JV is established. This particular structure is not further elaborated on as the unincorporated JV does not fall within the scope of this paper.
\(^9\) Shareholders should be mindful that, in terms of South African law, the MOI of the JV subsidiary will take precedence in the event of a conflict between the provisions of the shareholders’ agreement and the said MOI. It is vital to ensure alignment between these two sets of legal documents.
Second, by its nature as an NPO, some of the organisation’s strategies, policies and practices may be totally inappropriate for a profit company.

Third, which may be the most important and difficult challenge to manage, is ensuring that the subsidiary, in its pursuit of profits, acts as a corporate citizen in a responsible and ethical manner so that its actions do not negatively affect the reputation and work of the NPO. While this aspect is important for all companies, it is magnified in the context of an NPO.

By way of illustration: through the Framework, MOI, and other appropriate instruments, the NPO, as a holding entity, should:

- Set out the key policies relating to ethics, corporate citizenship and sustainability that it wishes to propose for adoption by the subsidiary;
- Identify the process in terms of which the strategy for the subsidiary will be developed and approved;
- Include reserved powers over certain critical aspects of the strategy that relate to, for example, the nature of investments permitted (ethical investments), or the expansion of the operational footprint (avoiding areas prone to human rights violations or labour practices); and
- Identify the principles and processes that will inform the development of commercial policies applicable to the subsidiary.

A similar challenge could arise where the NPC is a subsidiary of a for-profit company, as is common with various foundations that are created by major organisations. The approach should be similar, and the different operating context of the NPC must be taken into account when considering the implementation of group strategies and policies designed for a commercial environment. Of course, certain issues relating to culture and values, for example, may be universally applicable.

4.4. Public-Private Partnership (“PPP”)

A PPP refers to a separately established company that is owned in partnership by a private company and government (at national, provincial or local level) directly or indirectly through a state-owned entity.

The shareholders or ‘holding companies’ in this instance will be government (or the relevant state-owned entity) and the private company. The PPP may be part of each of the shareholder/holding organisations.

What is set out above regarding the 50% JV entity or a company with minority shareholders is equally applicable in the PPP structure, based on the relative shareholding.

However, it becomes increasingly complicated where the relationship involves government or a state-owned entity as shareholders, as there needs to be clarity regarding the extent to which certain public-sector policies and legislation will be applicable to the PPP.

In certain instances, such as in South Africa, where government or the state-owned entity has a majority interest, the PPP may be subject to the requirements of the Public Finance Management Act, No. 1 of 1999 (“PFMA”). Some of the requirements of the PFMA that need specific approvals by a particular minister, or that limit the scope of the PPP, may not be acceptable to the other shareholder.

It will, therefore, be necessary in these instances to ensure that, in the negotiations to establish the PPP, the implications regarding public-sector policy, governance and operational issues, are clearly understood. Where these matters are prescribed by law, each party needs to understand the implications of such requirements. Alternatively, to the extent that they can be agreed to, or that exemptions can be obtained for the particular PPP, these unique requirements need to be properly explored, and ultimately factored into the Framework.

In addition, the private shareholder/holding company will need to determine to what extent it can accept deviations from its own Framework, and consider whether the risks of such deviations are acceptable.
4.5. Dual board vs. unitary board structures

There does not appear to be any reason why a Framework may not be relevant to entities that have a dual board, as opposed to a unitary board structure. However, the process of adopting such a Framework, as well as the powers and authority for approval thereof, may need to be adapted for what is appropriate to the respective board structures.

5. Conclusion

A fine balance is needed to ensure alignment between the holding company and its subsidiaries regarding strategic direction and the implementation of appropriate policies and governance processes across a group of companies. It should be done in a manner that still recognises and respects the role of the subsidiary company directors and management.

The limitation of the authority of the board of directors of a subsidiary is not, by itself, an uncommon or unknown phenomenon. On the contrary, it is very common practice. However, where such limitation is not carefully thought through, adequately described, managed and governed, material risks are introduced for all involved, including the holding and the subsidiary companies and their boards.

Uniformity and control across a group may not necessarily be optimal, efficient or appropriate. As such, centrally-driven group uniformity might increase risk, undermine trust, and result in ineffective monitoring of adherence to applicable rules. What is therefore needed in any group of companies is alignment and empowerment of all entities in the group.

A Framework can contribute towards effective governance within a group. If designed and implemented appropriately, it can be a useful tool to align leadership and strategy, as well as encourage collaboration and integration, while at the same time maintaining accountability and empowering independent judgement by the various directors within the group.

Most importantly, it can be an effective tool to create value for each entity within a group by facilitating alignment on the material and important issues, rather than trying to control administrative processes that frustrate and slow down decision-making.
Appendix 1

Guidance on the content of a Framework for Group Governance

[In support of King IV Principle 16, Practice Recommendations 16, 17, 18, and 19]

The guidance provided herein should not be regarded as a checklist, nor be seen as exhaustive with regard to the areas to be considered or included in a Framework. Such a framework should be influenced, amongst other things, by the nature of each company in the group and the industry within which it operates.

Regarding the content of a Framework, the particular circumstances of the relationships, and the context within which the holding company and the subsidiaries operate will have a significant influence on what is important for the particular entities and how the relationships should be managed. Relevant considerations include, among others:

- The principle of proportionality;
- Whether the entities operate across jurisdictions; and
- Whether one is dealing with a wholly-owned subsidiary.

Despite these limitations and qualifications, some generic guidance can be provided regarding what should be considered for inclusion in a Framework, and such guidance is outlined below. Part A outlines the principles to apply, and part B offers a framework of the sort of content to include.
Part A. Principles

Subject to the above, the aspects listed in the table below should be considered when developing a Framework.

<table>
<thead>
<tr>
<th>Aspect</th>
<th>Content</th>
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</thead>
<tbody>
<tr>
<td>1. Leadership and governance</td>
<td>1. Protocol on engagement between group entities, including communication between the holding company and the subsidiary boards; and accountability at the holding and subsidiary levels for engagement, monitoring and communication on governance matters.</td>
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<td></td>
<td>2. Accountability for, and the process for determining, key governance outcomes, including culture, values and vision.</td>
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<td></td>
<td>3. Minimum governance standards and principles with regard to strategic direction, policy and planning; and effective monitoring and accountability, including reporting and disclosure.</td>
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<td></td>
<td>4. Accountability for, and the process as to how, subsidiaries are established, managed and wound up.</td>
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<td>5. Process for appointments to subsidiary boards and other structures, including minimum requirements regarding induction and ongoing training requirements; and the authority and the process for approving key executive appointments.</td>
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<td></td>
<td>6. Role and function of the holding company board committees vis-à-vis subsidiary boards and committees.</td>
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<td></td>
<td>7. Clear and effective dispute resolution mechanisms.</td>
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<tr>
<td>2. Strategy and performance</td>
<td>1. Accountability for, and the process of, developing strategy and setting targets.</td>
</tr>
<tr>
<td></td>
<td>2. Clarification of expectations, and determining integrated performance targets – i.e. economic, social and environmental performance.</td>
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<td></td>
<td>4. Risk management: Process for the identifying and managing risk, especially areas that represent specific risk in the context of the circumstances of the entities – for example, fraud and corruption in certain countries – and managing strategic, operational, ethical, reputational, information and IT risk.</td>
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<tr>
<td>3. Monitoring, oversight and assurance</td>
<td>1. Reporting format and requirements, including alignment on the process of integrated reporting and the Integrated Report in particular.</td>
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<td>2. Process for determining issues such as materiality and the Integrated Report scope and boundary; and accountability for the Integrated Report.</td>
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<td></td>
<td>3. Protocol for sharing information, including a disclosure of information protocol, especially where it is not a wholly-owned subsidiary, and where the subsidiary is a listed entity.</td>
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<td></td>
<td>4. Process for appointing external assurance providers; and guidance on how they will engage with each other across the group, including the requirements regarding mandatory audit firm rotation (where applicable).</td>
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<td></td>
<td>5. Standards and requirements for the internal assurance function, including reporting lines.</td>
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</tbody>
</table>
4. **Group policies**
   1. Clarity regarding the nature and extent of policies, processes, structures and procedures to be standardised, centralised or devolved to the subsidiary level; and the process for adopting group policies at the subsidiary level.
   2. Minimum requirement regarding which policies be in place; for example, policies regarding the management of human resources, dividends, compliance, tax, ethics, risk, cybersecurity and information management.
   3. Minimum criteria or guidelines for policies that are to be developed by the subsidiary; and the criteria and processes for deviating from, or adapting, group policies.

5. **Shareholder-reserved powers and delegation requirements**
   1. Limitation of authority of the subsidiary board or reserved powers (which will need to be given effect through the MOI or appropriate constitutive documents).
   2. Minimum requirements for the subsidiary *Delegation of Authority Framework*.

6. **Operating across jurisdictions**
   1. The extent to which key global strategies and policies apply in the context of local imperatives, including the following:
      - Appointment of expatriate personnel;
      - Recruitment and remuneration;
      - Meaningful investment in skills development;
      - Composition of governance structures;
      - Sourcing and supply chains; and
      - Establishment of a Social and Ethics Committee.

7. **Contracting between group entities**
   1. Pricing and cost principles, including transfer pricing and tax implications.
   2. Identification of shared services, including audit, human resources, remuneration and payroll.

8. **Implementation in different structures**
   1. Guidelines for the approach and implementation of the Framework in 50% JV companies, companies with minority shareholders, NPOs and PPPs.
Part B. Guidance on content

In order to give effect to the above, a draft table of contents is set out below, merely as a guide for consideration. This guidance should not be regarded as exhaustive, nor as a checklist for what is required. Each entity needs to apply itself to what is appropriate and proportionate for its circumstances, taking into account the guidance provided.

1. Introduction
   - Group information and background to the Framework

2. Group governance philosophy
   - Group’s view on, and approach to, corporate governance in general, but also specifically as it pertains to relations within the group

3. Ethical leadership
   - Guidance on ethical values and ethical leadership (including group and subsidiary board roles; and matters reserved for the holding company’s board and committees)
   - The role of relevant persons (such as group CEO, subsidiary CEO, group chairperson, subsidiary chairperson, group and subsidiary company secretaries, etc.)

4. Governance processes and structures
   - Subsidiary governance processes, including directors’ appointments and tenures, profiles of key roles on the boards, gender and race diversity, standards of director conduct (including the management of conflicts of interest), director induction and development, and director independence
   - Implementation of structures in different entities and jurisdictions

5. Authority and delegation
   - Delegation of authority to, and within subsidiaries

6. Key governance policies
   - Ethics and organisational culture
   - Strategy setting and implementation, reporting process, and performance monitoring
   - Group policy development and implementation
   - Operating across jurisdictions
   - Risk governance
   - Corporate citizenship
   - Compliance
   - Technology and information (including cybersecurity and social media)
   - Remuneration
   - Assurance, including the appointment of assurance providers, auditor rotation, and the interaction between assurance providers
   - Dividend policy
   - Custodian of the Framework
   - Other
7. **Reporting**
   - Guidelines for reporting within the group
   - Process for stakeholder engagement
   - Determining materiality for reporting

8. **Contracting within the group**
   - Guidelines for intra-group and group-wide contracting

9. **Dispute resolution**
   - Guidance on dispute resolution processes and mechanisms

10. **Implementation and monitoring**
    - Process for review and updating of the Framework