Corporate Governance in Portugal and Global Governance Challenges Ahead

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AGENDA

Global Corporate Governance Challenges

• The need for Societal Protection

• The need for Shareholder Protection

• The need for Stakeholder Protection

Corporate Governance in Portugal
THE NEED FOR SOCIETAL PROTECTION

Corporate Governance is important for society
By the OECD

Corporate Governance:
- Creates the confidence, within the company and across the economy, that is needed for the market economy to function
- Lowers the cost of capital
- Uses resources more efficiently
- Underpins economic growth
- Assures sustainability of the company as a “going concern”

OECD (2004) OECD Principles of Corporate Governance
THE NEED FOR SOCIETAL PROTECTION

From where does Corporate Governance derive its theories and practices?

- Law and Regulation
- Capital markets
- Corporate finance
- Management, leadership and performance evaluation
- Organization design
- Accounting and reporting
THE NEED FOR SOCIETAL PROTECTION

The first systemic and global crisis – the past 10 years

Interdependent and Contagious

Starts in the U.S.A. → EUROPE Rest of the World
Real Estate → Investment Banking
Investment Banking → Retail Banking
Financial Economy → Real Economy
Banks → Companies
Companies → Families

Budget deficits
Excessive debt
NATION STATES
The Subprime Crisis

THE EURO CRISIS
THE NEED FOR SOCIETAL PROTECTION

The first systemic and global crisis – the past 10 years

An accident waiting to happen

Context:
- huge liquidity — high risk taking
- very low interest rates
- continuously rising real estate prices
- strong credit expansion

And much more:
- sloppy supervision
- lax regulation ("light touch")
- complacent governments
- defective rating
- weak boards
- incompetent internal controls
- greedy management

Governance of Corporations
Governance of Institutions
(Governments, Regulators, Self-regulation, Rating Agencies)
Ethics and moral behaviour
THE NEED FOR SOCIETAL PROTECTION

Fighting the crisis had as a result...

- A renewed interest in corporate governance worldwide
- Revamped governance codes
- Particular focus on certain governance issues (ex. executive compensation)
- More attention to ethics
- Development of the stakeholder scrutiny on corporations
THE NEED FOR SHAREHOLDER PROTECTION

Many remedies were introduced in Government Policy, Regulation, Markets, Company Practices.

Even in the USA, where there is no generally accepted Code, because Corporate Governance is left to market forces, some far reaching measures have been introduced (Dodd-Frank Act):

- “Proxy Access” for Board member voting
- “Say on Pay” and “Say on Golden Parachute”
- “Clawback” of management bonuses
- “Pay versus Performance” and “Internal Pay Equity”
- “Board Leadership Structure”
- “Independence” of the Members of the Remuneration Committee and that of their Advisors
Many remedies were introduced

In Europe, the Shareholders Rights Directive II has been finally approved last year, requiring now transposition into each Member State’s national law. It is expected to be implemented during the second quarter of 2019.

This Directive establishes specific requirements to encourage shareholder engagement, in particular for the long-term. It covers:

- Remuneration policy and report
- Proxy advisors
- Disclosure requirements for institutional investors and asset managers
- Facilitation of the exercise of voting rights by shareholders
- Shareholder identification
THE NEED FOR SHAREHOLDER PROTECTION

Challenges are looming

The millisecond investor - High-frequency trading

ETF mania – The passive investor

The biased advisor – Proxy voting

The empire builder – Synergies vs. Human beings

The Sovereign – Hidden States
THE NEED FOR **STAKEHOLDER PROTECTION**

Building bridges between corporate governance and corporate responsibility

In Management, value creation is almost exclusively attached to **SHAREHOLDER VALUE**.

Indeed, the theory of the firm considers that the only legitimate purpose of a business is to maximize profits for shareholders (Milton Friedman, 1962).

Such a view is a reduction of reality. In fact, companies create real value not only for shareholders but to customers, workers, suppliers, communities, and many other stakeholders.

To assume that the only value created is economic value for shareholders, is simply no longer useful (R. Edward Freeman, 2012).
THE NEED FOR STAKEHOLDER PROTECTION

Building bridges between corporate governance and corporate responsibility

Corporate Governance and Corporate Responsibility are areas which, despite being very close, are visibly apart, both in academic terms and in companies’ practices.
THE NEED FOR STAKEHOLDER PROTECTION

Building bridges between corporate governance and corporate responsibility

In spite of efforts suggesting Corporate Governance should widen its vision beyond shareholders, and so embracing the interests of the other stakeholders, results have been frustrating (OECD strongly supports this view).

In the USA, the stakeholder vision in the governance of firms is circumscribed to Social Responsible Investment (SRI) and to Ethical Funds which, despite their recent fast growth in AUM, still represent a minor share in the total investment in capital markets.

In Europe, few are the Corporate Governance Codes that truly embrace the wider stakeholder principle. However, the new Directive on disclosure of non-financial (and diversity) information will help change this.
THE NEED FOR STAKEHOLDER PROTECTION

An integrating approach

- **REPUTATION**
- **CORPORATE GOVERNANCE**
- **SOCIAL RESPONSIBILITY/ Sustainability/ Citizenship**
- **Company/Personal ETHICS**

All these elements should make part of the STRATEGY of the company. They should be intertwined in its CULTURE and in its OPERATIONS.
Assessment of Corporate Governance practices in Portugal

Source: Report on the Degree of Compliance with Corporate Governance Recommendations
- Corporate Governance Index and Rating by Católica-Lisbon and AEM

The following international benchmarks were used as assessment criteria for the CMVM Code recommendations:

• The rules and recommendations from European Law
• The OECD principles on Corporate Governance
• The U.K. Corporate Governance Code
Assessment of Corporate Governance practices in Portugal

26.8% Issuers that are above 9.550 score points received a AAA rating

57.9% Issuers that are above 9.100 score points, received a AA or AAA rating

82.9% Issuers that are above 8.650 score points received a A, AA or AAA rating
THE CASE OF PORTUGAL

- Companies Code revised (Código das Sociedades Comerciais) - 2006
- CMVM supervised the quality of the information reported by companies and published an annual report analyzing the level of acceptance of the recommendations, as a means to stimulate and correct: “naming and shaming”.

1999 CMVM
- 1st. code
- Recommendations on the Governance of Publicly-Listed Companies
- 17 recommendations

1999 CMVM
- 17 recommendations

2000 CMVM
- 2003 CMVM
- 2005 CMVM
- 2007 CMVM
- 2010 CMVM
- Reaching maturity
- “Código de Governo das Sociedades”
- 43 recommendations

Cos. were expected to publicly report the level of acceptance of the recommendations and certain obligations. Became compulsory from 2001. The approach was “comply or explain”.

Lisbon, 5 July 2018

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THE CASE OF PORTUGAL

CMVM announces it abandons its Code, making way for private self-regulation.

Corporate Governance in Portugal: Report on Practices, Index and Rating

AEM – Issuers Association
IPCG – Portuguese Corporate Governance Institute

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THE CASE OF PORTUGAL

Questions needed to ask

What will be the role of the Regulator (CMVM)?

What will be the governance of the new system (IPCG, Issuers, ecosystem)?

Will the new system help develop companies and the Portuguese capital market?

How will the reporting of companies’ practices be managed?

Who is going to make a judgement on “comply or explain”?

How will global capital markets and investors judge the new system?

Answers from the Panel are expected
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