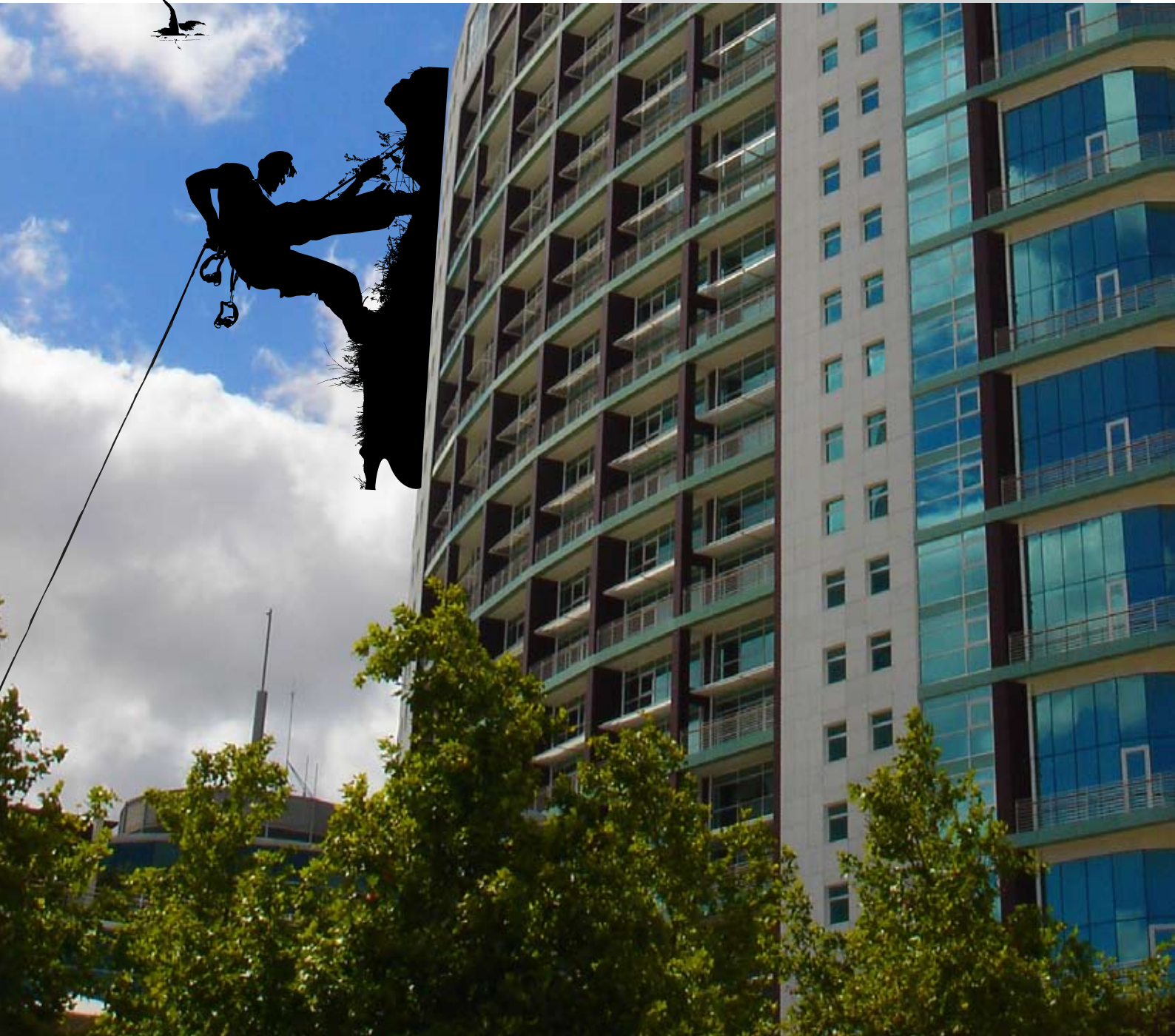


SUSTAINABILITY GOVERNANCE PORTUGUESE COMPANIES IN AN INTERNATIONAL CONTEXT



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NOTE: The quantitative analyses carried out in this study were based on information relating to the year 2007.



1. INTRODUCTION

“Corporate Governance has been practiced for as long as there have been corporate entities. Yet the study of the subject is less than half a century old. Indeed, the phrase ‘corporate governance’ was scarcely used until the 1980’s.... Present practice is still rooted in the 19th century legal concept of the corporation that is totally inadequate in the emerging global business environment ... what is needed is a vibrant alternative way to ensure that power is exercised, over every type and form of corporate entity and strategic alliance around the world, in a way that ensures both effective performance and appropriate social accountability and responsibility.” Bob Tricker 2009

The subject of corporate governance has evolved throughout the 20th century and has sought to define the role of the Board of Directors (BoD) in the management of companies, this role being intrinsically linked to the objectives that a BoD should be capable of achieving. In view of the fact that corporate governance can be understood as the manner in which a company is managed and for what purpose (Cadbury Report, 1992), good governance practices have evolved through time in accordance with cultural and social changes occurring in society.

At the beginning of the 20th century particularly in the USA and the UK, the number of companies listed on financial markets increased as well as the number of shareholders. This trend raised one of the main problems of corporate governance: the separation of powers and of information between those who manage the company (the BoD) and those who own the share capital of the company, in other words the

shareholders. At its core, the problem is simple, but is also linked to questions of ethics and personal integrity: sometimes, those who manage the company have access to privileged information resulting from day to day management, and can use this information for his/her own personal benefit instead of using it to defend shareholders, who in practice are their employers. In order to avoid problems of this nature, governance structures are implemented in companies, in which the responsibilities and rights of the different corporate players are defined. These players can be the BoD, managers, shareholders or any other stakeholder.

Since society’s expectations concerning the role that major companies should play in the economic and social system has changed over time, so too has that of the function of the Board Director. For example, in the 1970s it was believed that major listed companies had obligations that went beyond those established by law and also beyond those due to shareholders. This view held that BoDs should be accountable and report to a range of stakeholders, who might be impacted by the actions of these BoDs. This meant that BoDs should not only act to satisfy shareholders’ expectations, but should also consider customers, employees, suppliers, the local community and the state when taking decisions. In the 1980s, this approach was abandoned and replaced by a focus on shareholders’ interests, which led to the existence of “... a mindset focused on the market and on growth arising from the economic policies of Thatcher and Reagan” (Tricker, B. 2009, pp.12). This extreme focus led to a number of cases of insider trading and questionable practices, which prompted a discussion in the 1990s about the division of powers between the Chairman and Chief Executive.

During this decade, pressure from institutional investors and the media increased on Boards of Directors and individual directors. The importance that shareholder proxy votes could have on governance structures was also recognised, leading to an expectation that the responsibilities of BoDs should go further than those existing in the 1980s. Reports such as the Cadbury Report in 1992 and the King Report in 1995 are just some of the principal documents, which marked the beginning of a change of attitude concerning the functions and obligations of Board Directors. It was recognized that abuses of power had occurred, which led to recommendations being made to set up audit committees, to include independent non-executive directors on boards, to separate the duties of Chairman and Chief Executive, and to implement measures which would protect the interests of small shareholders.

There is no doubt that, today, society's expectations are changing concerning the performance of Board Directors. It is expected that company value will increase but not due to "creative" accounting; institutional investors point to situations of weak management and excessive remuneration, which demand improved corporate governance. The movement occurring in the 1970s that viewed companies as entities with responsibilities towards the societies in which they operate has acquired new vigour and a new perspective. At the end of the 1990s, environmental, social, ethical and human rights issues, among others, became part of the list of topics that society expected to see integrated into the policies of companies. This means that Board Directors are also expected to take a position and incorporate these issues into their decision making. Thus, the so called Corporate Social Responsibility (CSR), which proposes the integration of economic, social and environmental factors into company management, has brought a new approach to business that must be incorporated into existing governance models.

This research paper aims at identifying how companies have incorporated CSR issues into their governance models. The research was carried out using two different information sources: companies which make up the Dow Jones Sustainability Index, and Portuguese companies which form the PSI 20^[1] index of the Portuguese Stock Exchange. The research leads to identifying a number of actions, which Portuguese companies should take if they wish to reach the level of existing best practices and thus become more attractive assets to institutional investors.

This document begins with a brief explanation of the concept of corporate governance, as well as the historical development of the Shareholder, Stakeholder and Enlightened Shareholder Models. In view of the fact that the variables analysed by SAM to evaluate companies for listing on the DJSI are considered as a benchmark for identifying existing best practices, we have attempted to attribute the most appropriate SAM variables to each of these models. Based on the analysis that we have carried out, we consider that the Enlightened Shareholder Model should be considered as the most appropriate for the currently existing social, economic and environmental conditions and for the coming years.

NOTE: This text was based on the book "Corporate Governance – Principles, Policies and Practices", Bob Tricker. Oxford University Press. 2009



[1]The quantitative data analysed takes into consideration companies which in 2008 were listed on the PSI120 and the DJSI. In the case of Portugal, analysis of the PSI 20 included another company – Impresa – since, although it was de-listed in February 2008, can be considered to have some good governance practices. The quantitative data analysed relates to information for the year 2007.



2. SUSTAINABILITY AND GOVERNANCE

2.1. DEFINING SUSTAINABILITY AND CORPORATE GOVERNANCE

Corporate Governance

Corporate Governance can be defined as a system which controls and manages company activities. This system is made up of the policies, processes and people, which are necessary in order to meet the expectations of the company's shareholders and other stakeholders with integrity, respect, transparency and in a responsible manner.

There have been many individuals who have contributed towards explaining and providing training in Corporate Governance. However, it is particularly important to highlight the contribution of Sir Adrian Cadbury, who was responsible for the much publicised "Cadbury Report", which states that **"corporate governance is concerned with achieving a balance between social and economic objectives, and between the objectives of individuals and the company. The corporate governance matrix exists to encourage the efficient use of resources and also to ensure that someone is held to account for the way in which these resources are used. The goal is to align as closely as possible the interests of individuals, corporations and society"**. (Sir Adrian Cadbury, 'Global Corporate Governance Forum', World Bank, 2000)

Mervyn King, who wrote the "King Report", is another key reference in the development of Corporate Governance. He also uses a broad definition, recognizing

company directors as responsible for the appropriate management of company resources. He also states that directors should take into consideration the expectations of all stakeholders in the decision making process, not just shareholders. He also argues that transparency and accountability should always be present in a company's day to day activities, especially at board level.

However, the recommendations of the Portuguese Securities Regulator for publicly quoted companies in Portugal is focused almost exclusively on how companies should be transparent and accountable to their shareholders, and are much less specific in relation to their accountability to other stakeholders.

Despite the differences that exist about what constitutes good Corporate Governance, there is general agreement that Corporate Governance involves building a system involving people, processes and policies, which aims to achieve the following goals:

- The efficient use of the organisation's resources;
- Making the Board of Directors responsible to shareholders for the company's results;
- Aligning the interests of the Board with those of shareholders;
- Ethical and responsible conduct towards society and relevant stakeholders;
- Acting transparently towards all stakeholders of the company;
- Using the resources of the company, managing the expectations of all stakeholders, and making its long term profitability goals compatible with the principles of the sustainable development of society.

Corporate Sustainability

The definition of sustainability and Corporate Social Responsibility continues to be subjective and without consensual agreement in the business and academic world.

The definition of Sustainable Development, a legacy from the Brundtland report "Our common future", defines Sustainable Development as "development which meets the needs of the present without compromising the ability of future generations to meet their needs".

The concept of Corporate Social Responsibility adapts the Brundtland definition to the business context. It states that a company's responsibility does not simply involve maximising profits for shareholders but also carrying out its activities ethically in its dealings with all stakeholders and in relation to the eco-systems in which it operates.

"CSR is concerned with treating the stakeholders of the firm ethically or in a responsible manner. Ethical or responsible behaviour means treating stakeholders in a manner deemed acceptable in civilised societies. Social behaviour includes economic and environmental responsibility. Stakeholders exist both within the firm and outside. The wider aim of social responsibility is to create increasingly higher standards of living, while preserving the profitability of the corporation, for peoples both within and outside the corporation" (Hopkins, 2003, p. 1).

Thus, Corporate sustainability is understood as the ability of companies, through its governance practices and market presence, to positively influence ecosystems (improving natural resources, reducing pollution levels, etc), society (supporting local populations, creating employment etc.) and economic development (distributing wealth through dividends, paying fair salaries, respecting supplier payment obligations etc.). Companies with sustainability practices will be more likely to operate in harmony with the societies in which they operate, maintain their market presence and help maintain and increase profitability levels.

The concept of corporate sustainability therefore implicitly includes the following:

- Efficient management of the social, environmental and economic factors that affect the company, its business activities, products and services, and their

impact throughout the entire value chain;

- The management of stakeholder expectations, balancing and managing the social, environmental and economic risks that have the potential to adversely affect relationships with stakeholders of the company;
- Adoption of practices and behaviour, which are compatible with the values of society.
- The ability to offer products and services that attach environmental, social and financial value to their levels of quality, perceived as such by customers and providing a clear license to operate (from all relevant stakeholders).

The need to change the Governance paradigm

Embedded in the concept of Corporate Sustainability is the opportunity for companies to achieve a significant level of differentiation.

By adopting the concept of sustainability, starting from the core of the business - in other words the products and services that the company sells - and implementing it throughout the entire organisation, the company can develop strategies and management models that create social, environmental and economic value, generating higher levels of profitability in the short and long term. It is precisely in this respect that the concepts of corporate sustainability and corporate governance interlink and provide a new governance paradigm.

To maximise company value, it is essential to develop a system made up of people, policies and processes (Corporate Governance), which incorporates a positive response to the company's social, economic and environmental risks and opportunities that have the potential to influence the performance of the organisation.

We define "**Governance for Sustainability**" in this report as that Governance Model, which ensures the appropriate management of social, environmental and economic factors, taking into consideration and giving due weight to the expectations of society.

2.2. THEORETICAL MODELS OF GOVERNANCE

The need for governance models

The reason that governance models are important for companies is linked to the possibility that asymmetrical information may exist between Managers/Directors and Shareholders. In academic circles, this issue is known as the Agent/Principal Theory. This theory focuses on the fact that managers and shareholders can have different interests, due to asymmetrical information existing between the Principal (the shareholder) – who hires – and the Agent (Director/Manager) – who is hired to manage the company to maximise the profits of the Principal. The managers, who are responsible for the day to day management of the company, may have access to specific information, and may, if appropriate ethical standards are not in place, use it opportunistically in their own personal interest instead of using it in the interests of shareholders.

In the 21st century, the Principal/Agent Theory has gained particular relevance in relation to governance issues, since the beginning of the century was marked by financial scandals very much connected to issues of responsibility, transparency and governance. The Enron and Parmalat cases are just two examples. Thus, not only the theory but also the examples in practice can lead us to recognise that:

- The management and Board of Directors have an advantage in relation to shareholders and other stakeholders concerning the information to which they have access;
- Management and sometimes the Board of Directors have a natural tendency to give themselves preferential treatment;
- Stakeholders – in particular Shareholders – very often lack information and analytical knowledge about the situation of the company in order to effectively defend their interests through mechanisms existing specifically for this purpose;
- Managers/Members of the Board, who should represent the interests of shareholders, are often confronted with conflicts of interests related to their mutual interdependence.

The points mentioned above are some of the main issues which justify the importance of the existence of governance models and their mode of operation. The relationship between Managers/ Directors, Shareholders

and the remaining stakeholders can have different forms of theoretical expression, which can later be transformed into functional systems of company governance.

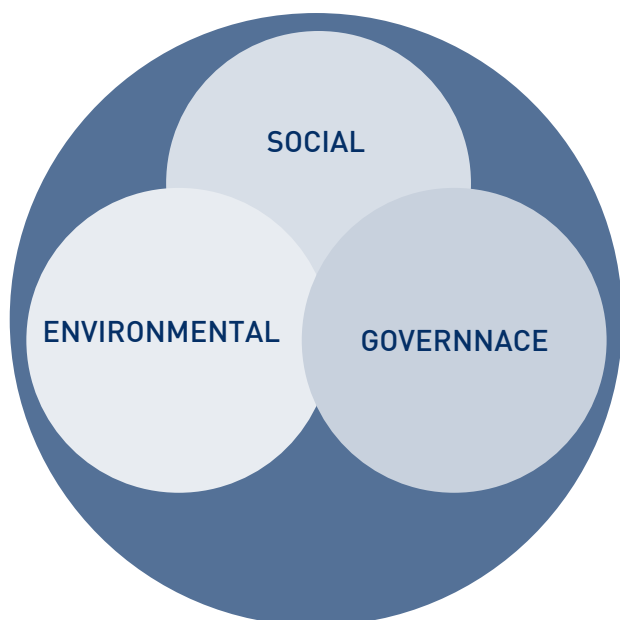
Despite the fact that theoretical Shareholder, Stakeholder and Enlightened Shareholder models exist, which can then be reflected in functional models normally referred to as the Latin/Strengthened Latin, Anglo-Saxon and German Models, we should never forget the cultural and historical context in which the companies in question exist. Governance models are a reflection of the economic, historical and legal background of a country, as well as of that of the business environment. They are also determined by the power structures that exist in the economy and by the available financial options for developing the business:

- The role that the financial markets, banks and insurance companies have in the economy
- The role played by the Government as shareholder and investor
- The percentage of free float shares on the market
- The level of share capital concentrated in one or more shareholders

The differences that exist in these areas may justify the existence of different governance models in the USA and within Europe (Miguel A. Mendez). So it is not surprising that there is no consensus about what constitutes good governance practices. In different countries, the success of similar models can vary. Different countries have different cultures, and society can have different expectations which can lead to different ways in which management practices develop. In spite of the knowledge of different societies about sustainability issues and the fact that the role of companies varies between companies in relation to this process, it is possible to highlight a number of studies which give credence to the empirical belief that society is becoming more demanding in relation to companies and the manner in which they should protect the environment and as a result promote sustainability. For example, in February 2009, a market study in the USA (Opinion Research Corporation, 2009) concluded that even in a recessionary period, the interest of Americans concerning environmental issues had not diminished and that consumers were paying more attention to what companies were doing in relation to environmental matters. Also in 2008, a worldwide study carried out by the National Geographic (National Geographic, 2008), which involved collecting information in 17 different countries, concluded that environmental problems were ranked 4th among the main problems faced by countries after those concerning the economy, unemployment and politics.

The increased pressure coming from society and regulators for companies to divulge how they are dealing with these emerging issues led to the idea that a good governance model should also be able to explain how sustainability issues are managed by the Board of Directors. In reality, since sustainability embraces economic, governance, ethical, social and environmental issues, some experts believe that Governance should be considered as an integral part of Sustainability, and not the other way around. This is also the implicit approach taken throughout this document.

SUSTAINABILITY: ENVIRONMENTAL, SOCIAL AND GOVERNANCE ISSUES



Source: Sustentare

In order to analyse how Portuguese companies listed on the PS120 and those on the DJSI are integrating sustainability, we based our study on existing theory, and examined our findings in the light of the good governance principles used by SAM. For Portuguese companies, publicly available information was used, while for DJSI companies it was possible to collect anonymized information supplied by SAM. Before presenting the main results found, we begin with a brief explanation of the different existing governance models – Shareholder, Stakeholder and Enlightened Shareholder – as well as the functional systems that governance models can have, such as the Latin/ Strengthened Latin Model, Anglo-Saxon and German Models.

2.3. THE SHAREHOLDER VS. STAKEHOLDER MODEL

Shareholder model

The theory supporting the shareholder model builds on the relationship between the owners of companies – the shareholders – and board directors. In countries such as the UK and the USA, in which the share capital of publicly quoted companies is highly fragmented among a large number of small shareholders, this relationship is based on the agency theory where the principal (the shareholder) delegates power and control to an agent (directors).

In this theoretical model, it is the market itself which does the job of controlling the quality of management of Boards of Directors (BoD) of listed companies, the goal of the BoD being to maximise gains for shareholders or, in other words, to maximise profits. Market scrutiny in relation to the quality of management is based on the idea that in competitive markets, there will be less demand for shares in under performing companies, resulting in a lower share price. This downward pressure on share price by market forces might lead to an increase in the vulnerability of the company to hostile takeovers (putting at risk the jobs of the Board and top management) or to a move by shareholders to replace those directors.

Under this theory, the Boards of Directors, by the simple fact that they want to protect their jobs and reputation, will always seek the best strategic direction to lead the company to success, maximising profits for distribution among shareholders.

The rationale behind this model is based on the following assumptions, which are seen by some as too simplistic:

- All relevant information is available. In other words, all economic agents involved (in this particular case shareholders and potential shareholders) have access to all relevant information to take well informed decisions;
- Market barriers do not exist, meaning that all economic agents can buy and sell shares without any limitations (the only limitation being their available income).

However in practice, these two assumptions are not always valid. In view of the simplicity of this model, particularly if we take into consideration the broad range of issues that can impact a company in today's world, it is not surprising that under the SAM evaluation system of the governance models of companies, a wide range of variables are analysed. In fact, some recent management scandals, involving situations in which the regulatory guidelines had not been followed, can be seen as a consequence of this simplicity. As a result, ideal conditions existed for managers (agents) to use privileged information in order to pursue their own interests rather than those of the shareholders

(principal). It is interesting to note that in some recent bankruptcies, clauses of a "golden parachute" [2] type in the contracts of board directors were common. It was also common that the remuneration packages for managers were indexed to the short term performance of company's shares. Short term incentives for directors have proved to be a potentially dangerous incentive to maximise profits. Instead of aligning the interests of the agent and principal in the short and long run, it can encourage unethical and illegal practices which can lead to the fall of profitable companies. This was what occurred in the case of Enron, or more recently, the Madoff scandal.

TABLE 1

SHAREHOLDER MODEL ISSUES	
AS RECOMMENDED BY REGULATORS	AS ASSESSED BY SAM FOR THE DJSI
Procedures for disclosing information in a trustworthy and transparent manner.	<ul style="list-style-type: none"> • Minimum number of independent board directors; • Chairman is neither CEO nor ex - CEO; • Members of strategy, risk management/audit and of selection, nomination and remuneration committees are non executive and independent.
Formal definition of responsibilities, contracts and remuneration conditions.	<ul style="list-style-type: none"> • Formal responsibilities of the Board of Directors: <ul style="list-style-type: none"> - Strategy; - Risk management/audit; - Selection, nomination and remuneration; • The remuneration of board directors is made public (preferably by individual director); • The system of evaluation of the performance of board directors is made public.
Inexistence of measures to protect board directors.	<ul style="list-style-type: none"> • Inexistence of a staggered board; • Inexistence of golden parachutes [2]; • Inexistence of limits to change the statutes; • Absolute majorities for merger/acquisition situations are not necessary; • Inexistence of poison pills [3].
Inexistence of market barriers.	

Source: Sustentare and SAM.

Stakeholder model

At the other end of theoretical governance models is the stakeholder model. According to the theory underpinning this model, the company no longer has the sole objective of creating value for the shareholder, but to create and distribute value for all its stakeholders.

This paradigm change has explanations based on two major premises:

- Ethical and moral arguments - which state

that the integration of these into questions relating to company management constitutes a moral responsibility towards stakeholders;

- Value creation - which states that, for a company to create value for its shareholders, it has to create and distribute value to all other stakeholders and meet their expectations.

Since the objectives of the company in this model are not limited to those of the shareholders, the interests of other shareholders will be represented at board level.

[2] Golden Parachuts: Lucrative benefits given to top executives in the event that a company is taken over by another firm, resulting in the loss of their job. Benefits include items such as stock options, bonuses, severance pay, etc. A golden parachute can be used as a measure to discourage an unwanted takeover attempt.

[3] Poison pills: A strategy used by corporations to discourage a hostile takeover by another company. The target company attempts to make its stock less attractive to the acquirer.

Employees, unions and suppliers have an active role in monitoring the performance of the board and management teams, and will even play a part in the definition of the company's strategy. The BoD has a duty to maintain a balance between the various stakeholders.

This model has been criticised by the advocates of the shareholder model because they consider it to be impossible for a company to follow several goals simultaneously, which can very often be contradictory. Those who believe in the stakeholder model reply that value creation for stakeholders creates value for shareholders (who are one group of stakeholders), and that in order to create value for shareholders, one must:

- Create and offer products and services that customers want to buy;
- Offer jobs in which employees are interested and which they are proud to hold;
- Build good relationships with suppliers so that they continue to work for the company;
- Be socially responsible in order to be accepted by local communities.

In short, profitability depends directly on satisfying the needs of the company's stakeholders.

In order for these governance systems to be successful, a number of basic criteria must be met, such as:

- The existence of a legal framework which defines precisely the roles of each stakeholder in the structure of each organisation ^[4];
- The ability of the representatives of each stakeholder group to effectively articulate their expectations and defend their interests;
- The ability of the board of directors to follow the various objectives of the various stakeholders simultaneously.

However, this model has significant limitations in practice, the main ones being:

- The tendency for conflicts of interest and disagreements among the various stakeholders to be resolved informally;
- The lack of transparency and manipulation of information destined for some stakeholder groups, the goal being to influence their decisions;
- The great difficulty (or even impossibility) of boards of directors to follow various objectives, which very often can be contradictory.

2.4. THE ENLIGHTENED SHAREHOLDER MODEL

This model arose from the basic premise that the two models presented above are not incompatible or mutually exclusive.

Thus, a synthesis of the advantages and limitations of the shareholder and stakeholder model is made, from which the Enlightened Shareholder Model arises. For this model:

- The main objective is to maximise shareholder value;
- It is assumed that to create value for shareholders, one must understand the expectations of the different stakeholders which influence and are influenced by the company, and act accordingly with the expectations of the main stakeholders of the company.

Therefore this model starts from the principle that for the company to be successful it must have:

- Satisfied customers, who wish to buy its products and services;
- Motivated employees, who wish to do the jobs available;
- Satisfied suppliers through being treated as business partners;
- A licence to operate from and acceptance by the communities among which it operates.

The model thus attributes critical importance to companies defining relationships with their strategic stakeholders. In turn, the strategic dialogue with stakeholders leads companies towards the need to integrate sustainability into their business models^[3].

In other words, this means that companies should take into account aspects such as:

- Ethics;
- Quality of products and services and customer satisfaction;
- Working conditions;
- Employee satisfaction;
- Strategic relationships with suppliers;

[4] As happens in Germany, where these kinds of competencies for workers representatives on Boards of Directors are precisely defined in legislation.

[5] The OECD principles for corporate governance can be seen as being based on this type of model.

- Involvement with the community and strategic philanthropy;
- Eco-efficiency and respect for the environment.

These are also the factors that are taken into account by SAM when evaluating companies which are part of the DJSI.

For companies to be able to meet these new requirements, it is essential that sustainability is integrated into their governance models.

We can thus say that companies, which wish to be categorised as having enlightened shareholder and stakeholder models, must provide the right answers to the questions asked in SAM's evaluation methodology.

TABLE 2

ENLIGHTENED SHAREHOLDER AND STAKEHOLDER MODELS	
DISTINCTIVE CHARACTERISTICS OF THE MODELS	SAM VARIABLES FOR THE DJSI
The importance of ethics	<ul style="list-style-type: none"> • Anti bribery and anti corruption codes and/or practices exist which are applicable to all company employees and all of its activities.
Quality of service and customer satisfaction	<ul style="list-style-type: none"> • Quantitative targets for customer satisfaction, as well as actual results, exist which are externally communicated; • Approaches exist for relationships and dialogue with customers, as well as for integrating their feedback into management; • A certified quality management system exists.
Work conditions and employee satisfaction	<ul style="list-style-type: none"> • Management and performance indicators in terms of ethnic diversity, gender equality, freedom of association and health and safety; • Whistle blowing procedures exist which ensure the confidentiality of those employees making a complaint; • Policies and performance indicators for training and competencies management; • Employee satisfaction surveys and their results; • Benefits given to employees over and above those that are mandatory by law (pension plans, health insurance, flexible working hours etc.)
Involvement with the community and strategic philanthropy	<ul style="list-style-type: none"> • The company should have a system which allows its social impact and contribution to be measured in order for it to be able to improve / realign its philanthropic strategy / investment in the community; • The company should report on its performance in the area of community investment using policies and quantitative indicators.
Respect for the environment and eco-efficiency	<p>The company has specific reduction goals for:</p> <ul style="list-style-type: none"> • Greenhouse Gas emissions; • Total energy consumption; • Total water consumption; • Waste generated. <p>The company periodically reports on its environmental performance. The company has a certified environmental management system.</p>

Source: Sustentare and SAM.

The level of integration of all these aspects into the company's organisation is evaluated through:

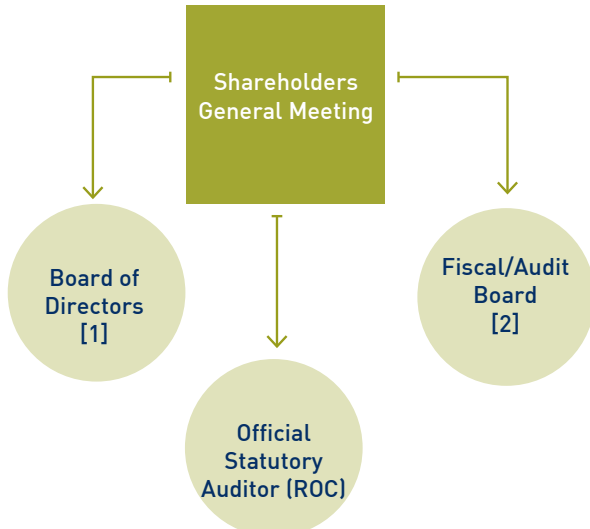
- The existence or otherwise of the formal responsibility of the Board of Directors for sustainability management, in other words for the integration of aspects relating to sustainable development into its governance model at the very highest level;

- The existence of variable remuneration that depends on the environmental and/or social performance of the company.

2.5. FROM THEORETICAL MODELS TO EXISTING BOARD MANAGEMENT SYSTEMS

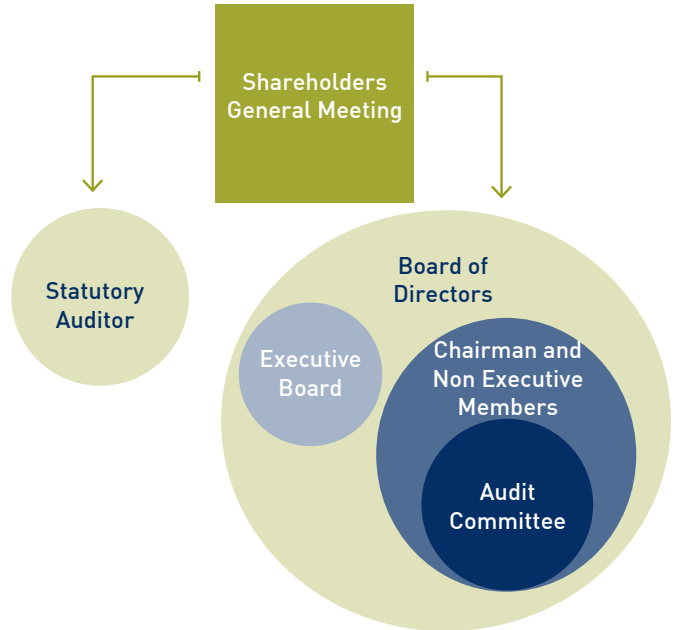
The three theoretical governance models presented in the previous section can be put into practice through different functional Board Management Systems, as the diagrams below demonstrate:

LATIN/STRENGTHENED LATIN MODEL

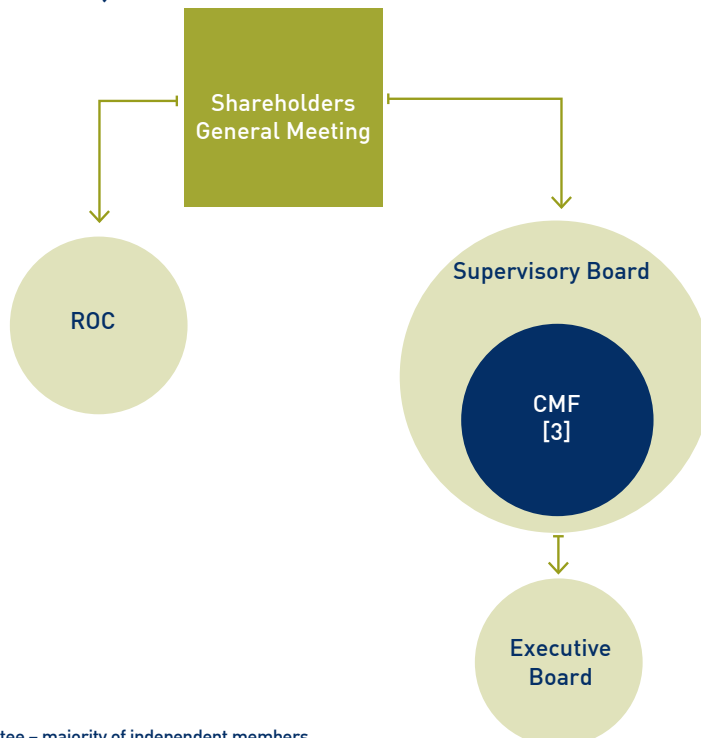


[1] Executive and Non Executive Members – have the role of “challengers” and involvement in decisions that are not part of the day to day running of the company
 [2] Majority of Independent members – have the role of auditing and following up on the executive management of the ROC

ANGLO SAXON MODEL



TWO TIER MODEL (GERMAN)



[3] Financial Matters Committee – majority of independent members

Source: The diagrams presented are based on: 2006, Carlos Tavares, CMVM, Company Corporate Governance and Social Responsibility; 2007, Christine A. Mallin, Corporate Governance

The table below is an attempt to explain the potential relationship that exists between theoretical models and systems of governance, in spite of the fact that controversy exists about the assumptions made.

TABLE 3: THE THREE TYPES OF CORPORATE GOVERNANCE SYSTEMS

ONE TIER SYST		TWO TIER SYSTEM	
A single board entity elected by the Shareholders' General Meeting.		Dual board entity in which, in most cases, only the supervisory group of board directors is elected by the General Meeting. Normally (but not necessarily), this is the entity that appoints the Executive Board of Directors.	
Close proximity (very often it is the same person) between the Chairman of the Board of Directors and the Chief Executive Officer		A high level of separation and independence between the Supervisory Board, which supervises, and the Executive Board of Directors, which executes.	
Shareholders have greater control and ability to influence the Executive Board		When the Supervisory Board elects the Executive Board, shareholders have less control and less ability to influence the Executive Board.	
SHAREHOLDER	ENLIGHTENED SHAREHOLDER	STAKEHOLDER	

Source: Sustentare

NOTE: The theoretical enlightened shareholder governance model is compatible with all board systems and models. The use of the German model does not necessarily mean that the Board is made up of representatives from different stakeholders. Historically, this model began life in Germany and imposes an obligation to have employees represented on the Board. Portuguese companies, which have adopted this model, have a Board of Directors compatible with the theory of the Shareholder or Enlightened shareholder model.

Supporters of the one tier model believe that with one Board level, there is a better relationship between all the Board directors and a better flow of information between them.

Supporters of the two tier model say that with a dual Board structure, a clearer separation of duties exists between those who supervise/evaluate and those who manage and are evaluated.

Whether the dominant structure is dual or unitary, the main concerns of the legislators in this area are the following:

- The manner in which the Supervisory Board and the Board of Directors function;
- The key committees of supervisory entities;
- The existence of a sufficient number of independent directors;
- Defending the rights of shareholders (especially minority shareholders).

3. ANALYSIS OF GOVERNANCE MODELS FOR SUSTAINABILITY USING THE SAM SUSTAINABILITY ASSESSMENT METHOD FOR THE DJSI

3.1. COMPANIES LISTED ON THE DJSI AND THE PSI20

3.1.1. CORPORATE GOVERNANCE SYSTEMS

Taking into consideration the three corporate governance systems defined above, and using the information publicly available, our conclusion is that the most commonly used model in Portugal in companies listed on the PSI20 is the Strengthened Latin Model. This model differs from those commonly used internationally by the fact that international models have supervisory entities made up of members, who are not members

of the Board of Directors. These members are elected at the Annual Shareholders General Meeting and are representatives of the majority shareholders of the companies involved. This difference is crucial when governance systems in Portugal are compared with international ones, given that almost 100% of DJSI listed companies use Anglo Saxon or German Models (with a separation between the Executive Board and the Board of Directors), while in Portugal this figure is only 39%.

TABLE 4: THE FORMAL RESPONSIBILITY OF BOARDS OF DIRECTORS

GOVERNANCE MODELS	COMPANIES (OUT OF 21) [PORTUGAL]	RESULT PSI 20+1 [PORTUGAL]	RESULTS DJSI
Strengthened Latin Model	13	61,9%	
Anglo Saxon Model	6	28,5%	81%
German Model	2	9,5%	19%

Source: Sustentare, SAM - 2007 data

3.1.2. THE SCOPE OF SUPERVISION AND ITS SPECIALISATION

Specialized committees for the management or supervision of organisations are a reality among the companies in the main Portuguese stock market index. The need for specialised executive management is natural and understandable. The same applies to the supervision of companies. Companies with better implemented governance systems will be those which will not only stimulate and improve the specialised executive management of its businesses but also their specialised supervision.

This new paradigm is even more relevant when we look at the diversification of business and expansion to new markets of Portuguese business groups. These two factors have made business groups more complex and more competitive, factors which make efficient

supervision of the organisation even more relevant by their respective supervisory boards and Boards of Directors.

The Board of Directors of a company is the representative of shareholders and as such has a responsibility to ensure the efficient management of the entire organisation. This entity thus has the responsibility of ensuring efficient executive management and supervision of the organisation with the goal of meeting the dividend expectations of the shareholder, while at the same time providing transparency and responsible behaviour towards all stakeholders.

In relation to the formal responsibility assumed by Portuguese companies in their Corporate Governance reports, the following table shows the frequency with which variables from SAM questionnaires are found in publicly available documentation:

TABLE 5: THE FORMAL RESPONSIBILITY OF BOARDS OF DIRECTORS

FORMAL RESPONSIBILITY	Companies (out of 21) [PORTUGAL]	Result PSI 20+1 [PORTUGAL]	Results DJSI
Strategy	20	95%	95%
Monitoring and supervision of management	19	90%	n.a
Risk Management	12	57%	96%
Audit	16	76%	
Selection, nomination and compensation of board directors	6	29%	94%
Corporate social responsibility, organisational citizenship and sustainable development	8	38%	84%
Compliance with current regulations, legislation and internal standards	15	71%	n.a

n.a: non-available

Source: Sustentare, SAM - 2007 data

The vast majority of Portuguese companies confirm the theory, which states that responsibility for the long term strategy of the organisation and the monitoring or supervision of day to day management is that of the Board of Directors.

Nonetheless, we are witnessing a process of change in the governance of listed Portuguese companies, in which, by taking on the responsibility for supervising executive management, Boards are beginning to segment, specialise and specify which kind of supervision

should be carried out at Board level. In particular:

- For 76% of companies listed on the PSI20, the Board of Directors has formal responsibility for the supervision of financial matters and all organisational audits (8 of which have the Strengthened Latin Model).
- For 57% of PS120 companies, the Board of Directors has formal responsibility for risk management supervision
- For 71% of PSI20 companies, the Board of Directors has formal responsibility for the supervision of

3. ANALYSIS OF GOVERNANCE MODELS FOR SUSTAINABILITY USING THE SAM SUSTAINABILITY ASSESSMENT METHOD FOR THE DJSI

- compliance with internal and external standards
- In only 29% of PSI20 companies does the Board of Directors formally recognise the selection, nomination and remuneration of Board Directors as its formal responsibility for the future success of the company, whereas for DJSI companies this figure reaches 94%
 - In only 43% of PSI20 companies does the Board of Directors assume formal responsibility for the supervision of Sustainability and Social Responsibility, whereas for DJSI companies the figure is 84%

two new areas, which are expected to begin to be part of the Governance agenda in Portugal in the near future. In general, it can be said that in terms of strategy and supervision, the responsibilities taken on by the Boards of Directors of PS120 companies do not differ significantly from those existing in DJSI companies. However, it is in the area of supervisory specialisation within the Board of Directors that the biggest differences exist between the two samples, namely in the risk management, audit, remuneration and sustainability/ social responsibility areas.

It can thus be inferred that issues relating to Sustainability/Social Responsibility and the selection, nomination and remuneration of Board Directors are

THE COMPOSITION OF THE BOARD OF DIRECTORS AND THE IMPORTANCE OF INDEPENDENT AND NON-EXECUTIVE DIRECTORS.

The relevance of the regulatory role of top management has simultaneously implied greater relevance for the role of Non Executive Independent Board Directors, since the responsibility for the supervision of executive managers of companies falls mainly to them.

By definition, the role of non executive directors is the supervision of executive directors, in the name of and representing all shareholders of the company, to ensure that executives are acting in the best interests of the company and its stakeholders.

With the increase in issues relating to supervision, the relevance of these directors is increasing, especially that of Non Executive and Independent Directors, who are entirely free from commitments to executive management, shareholders and any stakeholder which is dependent on the company or on which the company is dependent.

These are the Directors who ensure that Executive Directors are challenged, monitored and appropriately evaluated, according to the performance of the company.

Of the 21 companies analysed, only three have (in 2007) a majority of independent directors on their Boards: EDP, MBCP and Impresa.

TABLE 6

DIRECTORS	Companies (out of 21) [PORTUGAL]	Result PSI 20+1 [PORTUGAL]	Results DJSI
Majority of Executive Directors	5	24%	11%
Majority of Non Executive Directors	12	57%	36%
¼ of Independent Directors	13	62%	53%

Source: Sustentare, SAM - 2007 data

We can conclude that PS120 companies have already begun to take these issues into account, since around 57% of companies already have Boards of Directors with a majority of Non Executive Directors. Around 62% of PS120 companies have at least a quarter of Independent

Directors, a percentage which is slightly above that of the DJSI sample (53%).

Nonetheless, it should be noted that the criterion used by some Portuguese companies in 2007 as to what constitutes

an Independent Director is different from that used by SAM. For example, some listed PSI120 companies consider Executive Directors as Independent. A case also exists in which a company adopted a single tier model and discloses a greater number of independent than non executive directors. In 2008 however, some of these anomalies were corrected or changed, which also demonstrates how Portuguese companies are gradually adapting to the CMVM (Portuguese Securities Regulator) recommendations and international best practice.

3.1.3. SPECIALISATION IN SUPERVISION AND EXECUTION

It is common practice for listed companies to delegate their executive management to an Executive Committee made up of Directors with responsibilities for executing the proposed business plan. Among the Portuguese companies analysed, 18 delegated executive responsibilities and day to day management to an executive committee. This executive entity is common practice among the vast majority of listed companies.

However, it is also common for other specific committees to exist, which have the responsibility of supervising the organisation in specialist areas. These committees are in theory more efficient when they are made up exclusively of Non Executive Directors or Independent Directors.

Among the Portuguese companies analysed, 76% (16 companies) delegate audit and risk management to specialist committees set up for the purpose but only 14 of these are made up entirely of non executive directors. In comparison, 83% of DJSI companies have this audit committee.

However, Portuguese listed companies differ significantly from those on the DJSI as far as other supervisory functions are concerned.

- In relation to the Nomination or selection of Board Directors, only two Portuguese companies delegate these functions to a specialist entity made up of non executive directors. 68% of DJSI companies have this committee, showing clearly that it is common practice among international companies listed on this index.

REPORTING THE INDIVIDUAL REMUNERATION OF BOARD DIRECTORS:

Reporting the individual remuneration of Board Directors is a recommendation made by the majority of regulators in different countries, and Portugal is no exception. No companies analysed in the Portuguese market (in 2007) reveal this information or complies with the recommendation. In the DJSI, 30% of companies report this information.

- In relation to the remuneration and salaries of Board Directors, the same trend is apparent. In Portugal, only 3 companies have committees made up of non executive directors with the specific task of supporting the Board of Directors by making proposals for the remuneration of directors. In the DJSI, 81% of companies already have this committee, and thus can be considered to be common practice among companies making up this index. Again it is important to remember that the Portuguese stock exchange regulators, in accordance with the principles of the Latin Model, recommend that a group of shareholders, in a specific board committee, determine and propose the remuneration of all Directors.

TABLE 7: SPECIALIZED SUPERVISORY COMMITTEES OF THE BOARD OF DIRECTORS

SPECIALIZED SUPERVISORY COMMITTEES OF THE BOARD OF DIRECTORS	Companies (out of 21) [PORTUGAL]	Results PSI 20+1 [PORTUGAL]	Results DJSI
Audit and risk management committee or equivalent (made up of non executive directors)	13	60%	83%
Nominations Committee or equivalent (made up of non executive directors)	2	24%	68%
Remuneration Committee or equivalent	2	19%	81%
Sustainability Committee	5	24%	44%

Source: Sustentare, SAM - 2007 data

3.1.3.1. SUPERVISION AND EXECUTION IN THE AREA OF SUSTAINABILITY – GOVERNANCE FOR SUSTAINABILITY

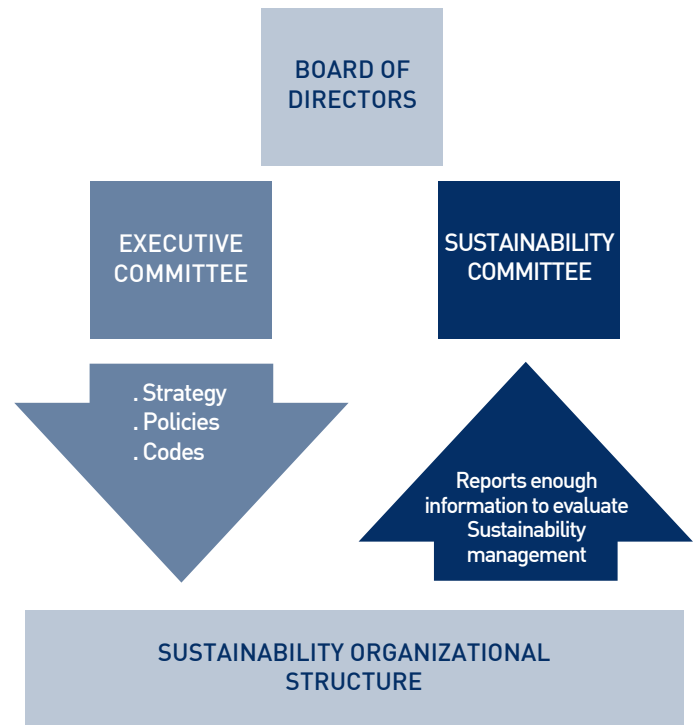
The relevance of sustainability for the business activities of organisations has led, as we saw earlier, to the need to include sustainability management as a direct formal responsibility of Boards of Directors.

It is important to understand how Boards of Directors are putting governance in place for sustainability, bearing in mind that they must pay attention to both the executive management of sustainability and its supervision, according to the definition of the Enlightened Shareholder and Stakeholder Governance model.

We previously noted that 9 Portuguese companies took on this area as a formal responsibility of the Board of Directors. Of these 9, 6 have chosen to set up formal committees made up of directors, who discuss, supervise and make recommendations to the Board of Directors to manage sustainability in the organisation. This tendency in the Portuguese market is also reflected in the DJSI: 44% of the companies in the index have a specialised committee exclusively for sustainability matters at top management level.

Such evidence leads to the conclusion that companies are concerned not only with specialising and broadening the scope of their supervision, but also see the supervision of sustainability management as being a critical factor. In other words, management of social, environmental and economic factors which impact relevant stakeholders of the company is so important to their profitability that a significant share of the companies in the DJSI sample have opted to include its supervision and guidance within the scope of the responsibilities of Boards of Directors, delegating the formal monitoring of these matters to specific directors.

GOVERNANCE FOR SUSTAINABILITY

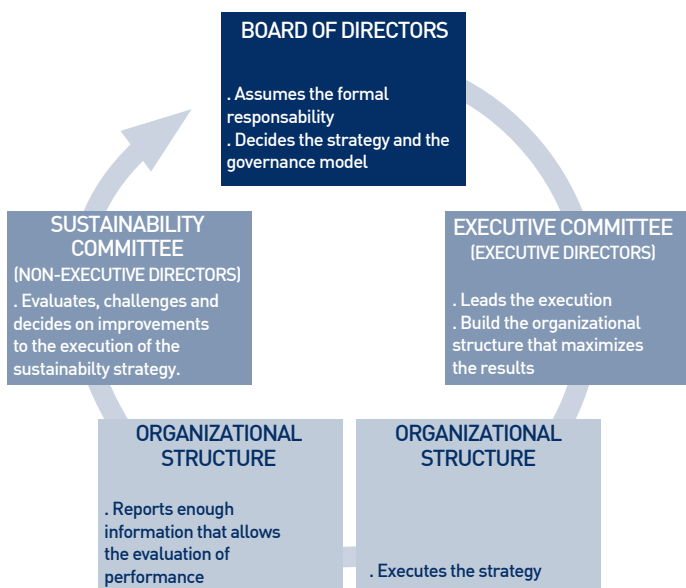


Source: Sustentare

In terms of execution, it follows that, having assumed formal responsibility, companies will seek to develop a strategy, a programme or plan of action, which manages and executes the sustainability agenda, and for which the executive committee is the main driver and responsible for the implementation of this strategy. Among the Portuguese companies analysed, 12 companies communicate clear guidelines for its sustainability strategy. However, only 9 companies communicate the organisational structure that manages sustainability and enables the strategy to be implemented, evaluated and communicated internally and externally.

The organisational structure that manages sustainability is a crucial element in achieving the objectives announced to stakeholders to manage environmental, social and economic factors. It is also an opportunity for differentiation by companies, since, in view of the complex, multi-disciplinary nature of sustainability, cutting across organisational boundaries, there is no magic formula for setting up an efficient organisational structure.

THE WAY GOVERNANCE FOR SUSTAINABILITY WORKS



Source: Sustentare

It is important to establish a structure that enables the strategy approved to be executed by Executive Directors, and supplies information to Non Executive Directors supervising the company, about the results of this strategy.

TABLE 8: GOVERNANCE FOR SUSTAINABILITY IN LISTED COMPANIES IN PORTUGAL

GOVERNANCE FOR SUSTAINABILITY	Companies (out of 21) [PORTUGAL]	Results PSI 20+1 [PORTUGAL]
Formal responsibility of the Board of Directors for Sustainability Management	8	38%
Specialised committee for Sustainability Supervision	5	24%
Sustainability Strategy	11	52%
Organisational structure for sustainability management	8	38%

Source: Sustentare, SAM - 2007 data

Among the companies in the DJSI, it can be seen that, in addition to a strategy and a structure that manages sustainability, these companies have methods of evaluating the investments that they make in sustainability, such as for example:

- 53% state that sustainability brings benefits to the business;
- 79% state that social results and their impact have been evaluated;
- 71% state that the impact on corporate

reputation and stakeholder satisfaction has been evaluated;

- 71% state that they carry out employee satisfaction surveys;
- 95% state that they have set up “whistle blowing” systems, which ensure employee anonymity.

Taking all the information above together, we can conclude that the Boards of Directors must build a virtuous cycle of management and supervision, which

3. ANALYSIS OF GOVERNANCE MODELS FOR SUSTAINABILITY USING THE SAM SUSTAINABILITY ASSESSMENT METHOD FOR THE DJSI

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enables them to respond with quantifiable results to relevant stakeholders, who are increasingly concerned with the company's long term profitability and "licence to operate".

These results show that the first steps in Portugal have been taken. We have companies such as Portugal Telecom and EDP which are familiar with the concepts and practices reported in this section. The challenge will be to transform these practices and make them commonplace among the top listed companies in Portugal.

THE STATUS OF SELF REGULATION AMONG LISTED COMPANIES IN PORTUGAL

Due to growing societal pressures concerning the role of companies, NGOs and civil society are gradually beginning to debate the legitimate role of companies in the search for solutions to existing environmental and social problems. The increasing dialogue about this issue between society and the private sector has led to institutional agreements being signed, the first of which occurred in the USA in the 1970s. These aimed at implementing preventive measures against bribery that might occur when American companies were running businesses in other countries (Wright, 2006). Over time, and in line with the changing expectations of society, these codes of conduct gradually began to include social

and environmental issues (Wright, 2006). The codes were an attempt to fill potential gaps existing between legislation in force and the expectations of society, thus enabling the private sector to carry out actions, the goal of which was "... to support public political objectives concerning social and environmental causes" (Labatt and Maclaren, 1998 mentioned in Richardson, 2005, p.281).

Since these codes are the result of a number of stakeholder expectations, they can be considered to be "soft law", which may later be transformed into real legislation (Scholtens and Dam, 2007). Given that societal expectations vary over time with various standards being established by different institutions, the functional organisation of companies also needs to change in order to be able to respond to external institutional pressure.

In specific terms, the Enron and/or Parmalat cases at the start of the millennium, or the recent scandals involving unethical behaviour in the banking world, the need to fight climate change or concerns over the supply limitations of natural resources, have led to companies developing internal and voluntary codes of conduct or adopting international codes. So it is relevant to understand how companies are implementing these kinds of standard:

TABLE 9

GOVERNANCE FOR SUSTAINABILITY	Companies (out of 21) [PORTUGAL]	Results PSI20 + 1 [PORTUGAL]
Sustainability Mission (economic, environmental and social factors)	13	62%
Values include sustainability (economic, environmental and social factors)	15	71%
Business principles include sustainability (economic, environmental and social factors)	8	38%
Ethical code	9	43%
Code of Conduct	12	57%
Code of Conduct regulating public lobbying	2	9,5%
Code of Conduct in relation to sexual harassment	2	9,5%
Code of Conduct relating to human rights	9	43%
Code of Conduct relating to environmental protection	9	43%
Code of Conduct relating to sustainability	9	43%
Code of Conduct relating to conflicts of interest	7	33%

Source: Sustentare, SAM - 2007 data

Based on these results, we can therefore state that:

- Self regulation of PSI120 listed companies is a growing reality, with more than 50% of companies showing evidence of practices of this nature
- However, the transition from Mission and Values to Codes of Conduct was only achieved by nine companies
- Only two companies have internal codes which regulate public lobbying activities, and only two deal with sexual harassment in their codes. Seven companies have codes concerning conflicts of interest
- In Portugal, the CMVM recommends the existence of whistle blowing procedures, and 14 companies comply with this recommendation

The standards that regulate the behaviour of the entire organisation serve as a benchmark for employees as to what is acceptable and unacceptable behaviour, given the reality, culture and history of the company. Self regulation is a factor which has been encouraged by regulators and is valued by most stakeholders, supporting any strategy which is focused on the principles of sustainable development and company social responsibility.





4. STAKEHOLDERS EXPECTATIONS AND THEIR INTEGRATION INTO GOVERNANCE MODELS

4.1. IMPLICATIONS FOR GOVERNANCE MODELS

Responding to stakeholders means a change in the way that companies do business, forcing top Board management to adopt new Governance models, designed to respond to stakeholders who impact or are impacted by its activities through actions and results.

This implies abandoning the Shareholder Model theory and adopting a realistic, efficient and practical model, focused on value creation, not only in the short but also in the long term.

In practice, no company has all stakeholders represented on its Board of Directors, nor has objectives which satisfy simultaneously all relevant stakeholders of the company. Under current market conditions, this means that the implementation of a stakeholder model in its theoretical form is not viable.

Thus, companies which are investing in sustainability in a consistent manner have adopted Governance Models, which meet the short term profitability needs of shareholders, but at the same time always take into account their "licence to operate" and future profitability. The Enlightened shareholder model is in theory the best practical response of organisations, which have decided to invest in sustainability. With this model, they can respond to the expectations of all stakeholders by demonstrating practices and results, while presenting

not only financial but also non financial information to their shareholders, which answers the needs of those shareholders who are concerned about sustainable development values and the long term market viability of the company.

For this, companies have to ensure the following:

- The Board of Directors must take on formal responsibility for the management of the expectations of stakeholders and society, responding to the factors that influence the sustainable development of the organisation and society; A Governance Model must be developed, which separates and differentiates executive management from the supervision of areas related to Sustainable Development;
- A sustainability strategy must be built and integrated into business strategy, which meets the profitability needs of shareholders and their expectations concerning the company's relationship with other stakeholders, in order to guarantee a license to operate in the short and long term;
- An organisational structure has to be implemented, which allows:
 - A commitment to Sustainable Development to be made across the entire organization;
 - Relevant stakeholders to be involved and influenced;
 - Results to be measured and evaluated
- Results to be independently communicated by executive management to Non Executive Board Directors who have responsibility for challenging

executive management;The company must have a set of standards and a self regulatory framework. This means that the organization has to be made aware of the need to invest in new practices and ways of doing things, which are ethical, responsible and in line with the requirements of society;

- Procedures must be implemented to ensure compliance with the ethical standards adopted;
- Consistent reporting procedures must be provided for relevant stakeholders.
- Mechanisms must be created to promote transparency with shareholders in order to respond to non financial expectations about company management, which will allow a license to operate to be granted to the organization in the long term.

4.2. EXAMPLES OF THE INTEGRATION OF STAKEHOLDER EXPECTATIONS INTO GOVERNANCE MODELS

Over the last decade, concerns about sustainability among companies have increased, which has also led to an increase in their investment on issues related to CSR. The Dow Jones Sustainability Index is an opportunity for companies to differentiate themselves. In fact, the DJSI considers sustainability as a business model that allows companies, which take economic, social, and environmental risks and opportunities into consideration in their management decisions, to be identified.

We describe below some examples of the inclusion of the expectations of shareholders and of stakeholders in the governance models of companies in the banking, construction and retail sectors. These companies are considered to be worldwide leaders in sustainability among their competitors in terms of the implementation of sustainability within their organisations. (they have also been singled out as leaders in sustainability 2007/2008 in the "The Sustainability Yearbook 2008", SAM and PriceWaterHouseCoopers).

In addition to meticulously complying with the main guidelines of the regulatory entities, which are equivalent to the SAM variables/ shareholder analysed in section 2, they also have characteristics, which would place them in the group of organisations that fit within the scope of the enlightened shareholder and stakeholder theoretical models.

4.3. EXAMPLES IN THE BANKING SECTOR

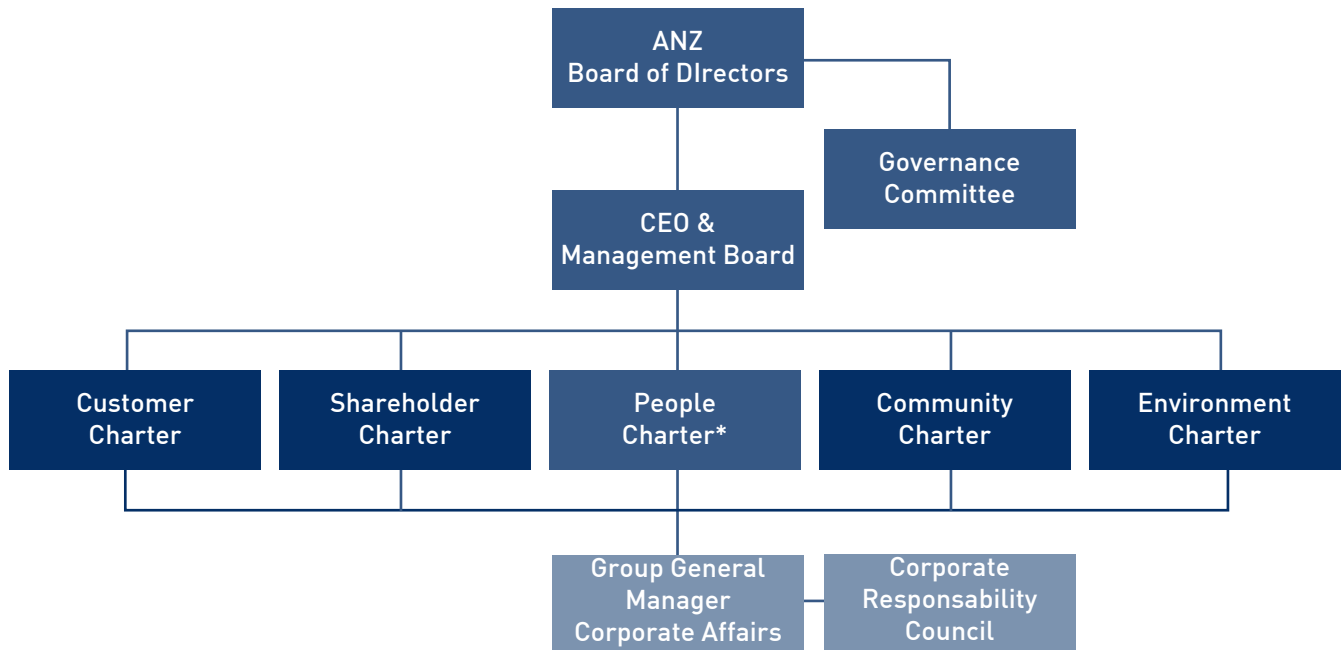
The Australia and New Zealand Bank (ANZ): an example of a multi-disciplinary organizational structure.

The governance structure of this bank has all the characteristics of a one tier board of directors and the Anglo Saxon board model. The main feature supporting this statement is the fact that a single board entity exists, elected by the shareholders' general meeting. The Board of Directors (BoD) in their turn has delegated the authority and responsibility for the day to day management of the bank to the CEO (who is a member of the Board of Directors) and through him to other executives (these directors and the CEO make up the Executive Board of Directors(EBD)).

There are 5 Board of Directors Committees, made up only of independent directors, to which the BoD has delegated powers and responsibilities in the following areas: Audit, Governance, Human Resources, Risk and Technology.

4. STAKEHOLDERS EXPECTATIONS AND THEIR INTEGRATION INTO GOVERNANCE MODELS

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* The People Charter will be launched 2008

Source: ANZ - CSR Report 2007.

The BoD, based on an exercise undertaken to identify and consult with strategic stakeholders, concluded that issues related to sustainability and stakeholder dialogue were extremely important for the bank's performance. It thus set up:

- The Social Corporate Responsibility Board (SCRB), with supervisory and advisory duties. It is made up of executive directors and led by the Chief Financial Officer (CFO). The formal responsibilities of this board are:
 - Identifying and following up on sustainability risks and opportunities;
 - Informing and advising the BoD with the aim of providing a better response to these risks and opportunities;
 - Defining targets and commitments in the sustainability area, in conjunction with the Executive Board of Directors (EBD);
 - Integrating sustainable management policies and systems throughout the company;
 - Evaluating and approving all significant costs necessary for the implementation of the sustainability strategy.

The SCRB was set up together with the Corporate Social Responsibility Charters, aimed at the main stakeholders of the bank:

- *Customer Charter;*
- *Shareholder Charter;*
- *People Charter;*
- *Environmental Charter;*
- *Community Charter.*

The strategic priorities and objectives, the commitments and governance structure responsible for its implementation are defined in these Charters. Thus, the bank seeks to meet the expectations and priorities of its strategic stakeholders, integrating them into its business model.

Westpac and the integration of sustainability at the Board of Directors level

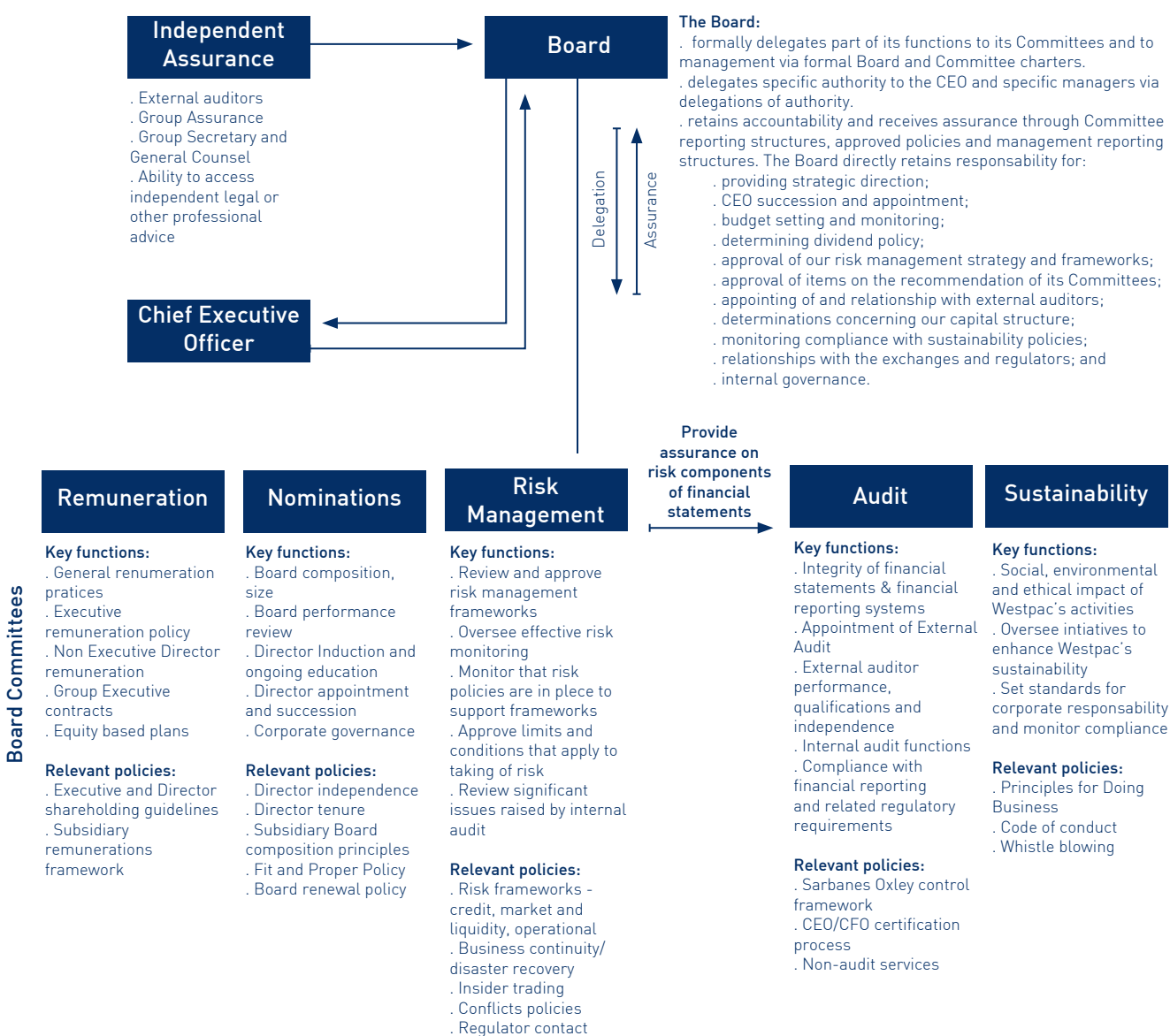
The governance structure of this bank is similar to the previous bank (ANZ) in respect of the model and board system (Anglo Saxon and one tier respectively).

The major difference is in terms of Board committees, in particular the existence of a Sustainability Committee at the highest governance level.

This is of great importance, since it implies that the integration of sustainability into the business model is something that adds value to the shareholder (a typical feature of the enlightened shareholder model).

For this integration to take place in an effective manner, specific governance structures have to be set up and strategic shareholders consulted.

WESTPAC GOVERNANCE FRAMEWORK



The Executive Office, Disclosure Committee and Executive Risk Committees sit beneath the Board and its Committees to implement Board approved strategies, policies and management of risk across the Group.

4. STAKEHOLDERS EXPECTATIONS AND THEIR INTEGRATION INTO GOVERNANCE MODELS

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It was with this in mind that the Sustainability Committee was set up (led by a non executive independent director and of which the CEO and another independent directors are members), and it has functions that are similar in all respects to the CRSC of the ANZ.

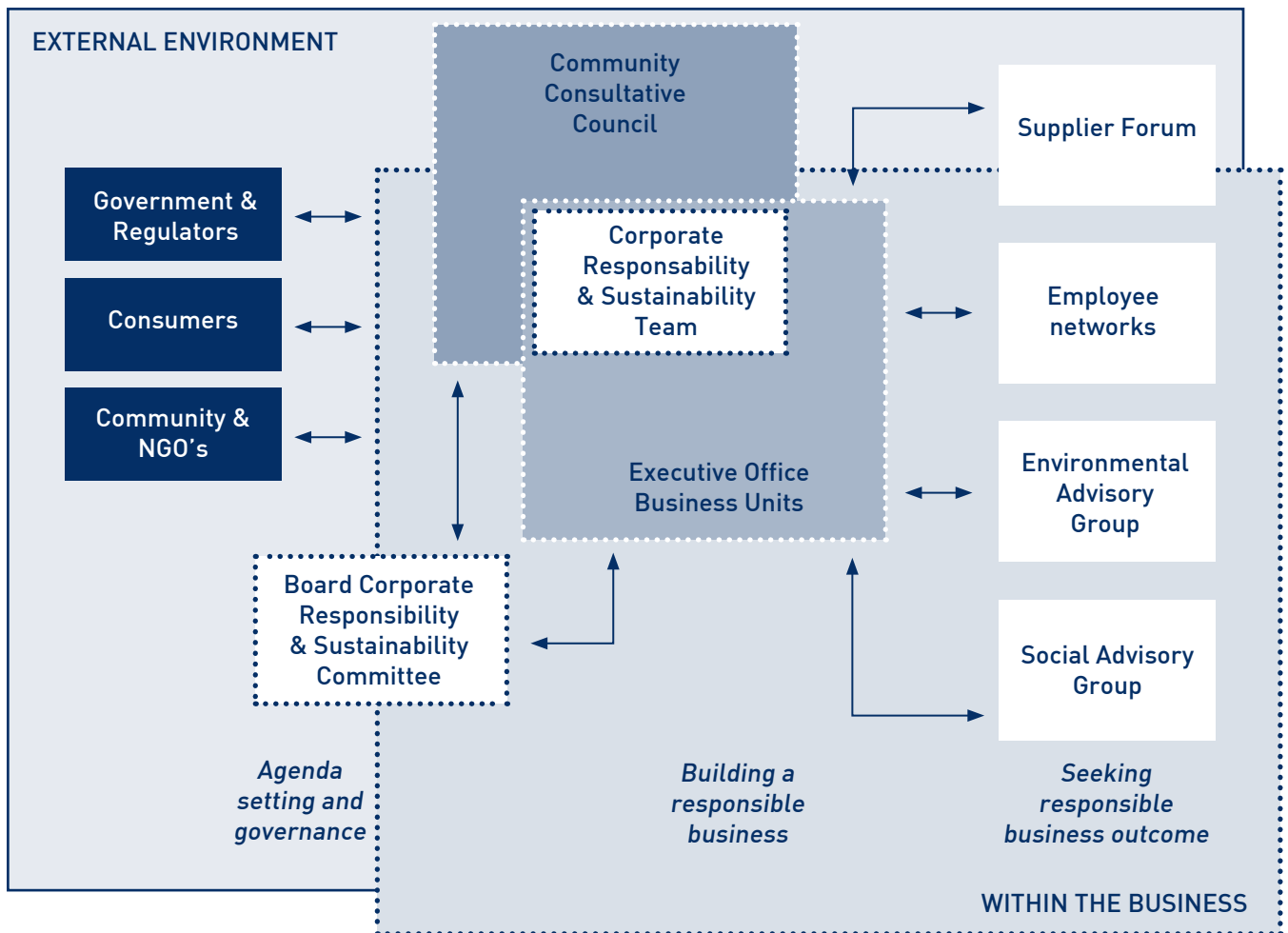
As a privileged source of information for strategic decision making, this committee has available a means of relating to stakeholders, the highlight of which is the existence of a Community Consultative Council.

The council is chaired by the CEO and includes high level

representatives from strategic stakeholders. These representatives are asked what the priorities are in relation to sustainability for the banking industry and for the community. Westpac collects this information and responds to it.

Also, much of what is reported in sustainability reports comes from guidelines given by this council.

WESTPAC STAKEHOLDER ENGAGEMENT FRAMEWORK



Source: <http://www.westpac.com.au/about-westpac/sustainability-and-community/our-approach/stakeholder-engagement/> [25/01/10]

Deutsche Bank and the practical application of the stakeholder model in the German model and two tier system

The governance structure of this bank has all the features of a two tier board system and the German Board model. The distinctive feature, which places it in these two groups, is the fact that a dual board structure exists, made up of a General Supervisory Board (GSB) and an Executive Board of Directors (EBD).

The members of the GSB are elected by shareholders at their general meeting and by employee representatives (currently it is made up of 20 members, 9 of whom were elected by the employee representatives) and its functions are to:

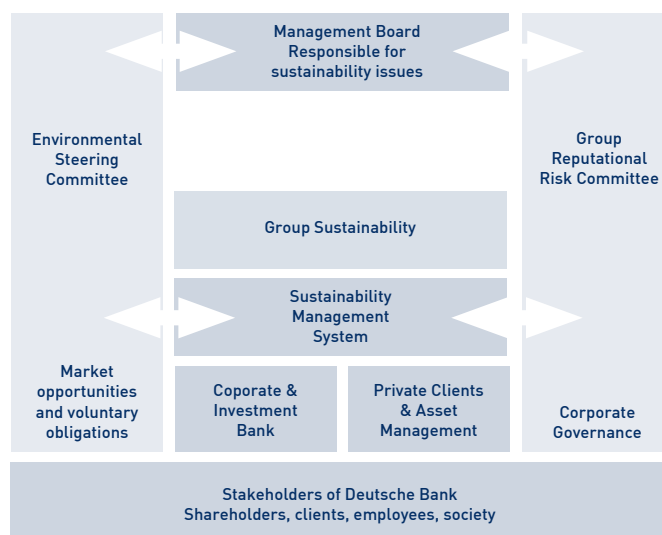
- Nominate members of the EBD;
- Supervise and evaluate the performance of the EBD;
- Advise the EBD, being directly involved in all issues of strategic importance to the bank.

The GSB has established five committees with specific responsibilities. The presence of members on almost all of them, who are elected by the employees' representatives, should be noted:

- Chairman's Committee: Responsible for all EBD and GSB subjects, made up of 4 members, 1 of them elected by the employees' representatives;
- Nominations Committee: Prepares and proposes shareholders' representatives for the GSB, made up of 3 members elected by the shareholders;
- Audit Committee: Responsible for all financial audits and for discussion of audit reports with the independent external auditor. It is made up of 6 members, 3 of whom are elected by the employee representatives;
- Risk Committee: Responsible for the evaluation of loans, which require an opinion from the GSB, and made up of 3 members elected by the shareholders;
- Mediation committee: Mandatory by German law, it has the job of making proposals to the CGS for the nomination or dismissal of members of the EBD in situations where the GSB cannot reach a decision by a majority of two thirds. It is made up of 4 members, 2 of which are elected by workers' representatives.

Based on the above evidence, the integration of employees into the bank's governance model at the very highest level and with an influence over strategy is apparent.

SUSTAINABILITY MANAGEMENT SYSTEM: CONTROL AND FUNCTIONS



Source: Deutsche Bank - CSR Report 2008

Despite the big differences in the top management models of the two banks described above, Deutsche Bank (DB) has also integrated sustainability into its governance, basing its strategy on stakeholder dialogue.

Based on the issues identified through this dialogue, the DB implemented its Sustainability Management System, for which the EBD has the maximum responsibility.

It should also be noted that two inter-departmental committees exist with responsibilities in relation to strategy development and coordination of initiatives.

A final point is that all these banks have formal codes and policies covering all relevant sustainability issues, which must be followed by all employees.

4.4. EXAMPLES IN THE CONSTRUCTION SECTOR

Balfour Beatty and the importance of policies and codes of conduct

This British construction company has a governance model which is very similar to ANZ and Westpac.

The fundamental values of this company are:

- Integrity – Always do what is right;
- Team work – Add value working together;
- Excellence – Seeking to exceed customers' expectations;
- Respect – The importance of community involvement.

These values are put into practice through a set of formal documents applicable to all employees and activities of the company. Major highlights are:

- Code of Conduct guidelines– which explain to employees how they should act, and which are based on the principles of sustainability;
 - Stakeholder codes – which define the key principles and minimum requirements for relations with employees, customers, suppliers and society in general.
- The policies, which define the requirements applicable to all business operations of the company, are:
- Risk Management;
 - Health and Safety;
 - Environment;
 - Human rights;
 - Drugs and alcohol;
 - Equal opportunities;
 - Whistle blowing;

Against this global and wide ranging framework, the different subsidiaries of the company must develop policies and practices specifically adapted to their particular circumstances.

The Board of Directors has the highest level of responsibility for all of these policies, and a Business Practices committee has been set up to oversee this specific area. The Chairman of the Board of Directors

and other non executive independent board directors are members of this committee. The CEO is also present at meetings as the executive responsible for the necessary procedures to correctly implement the policies and codes.

HOCHTIEF and the Social Corporate Responsibility Steering Committee

This company has a German governance model, very similar to that of the Deutsche Bank. The integration of sustainability into the governance of the company is achieved firstly by the set up of an Environmental, Health and Safety System. The responsibility for the implementation of this system is with a Centre which brings together employees from various divisions of the company (the Centre for Occupational Health and Safety and for the Environment, the OSHEP Centre).

In order to increase the level of integration of Sustainability into the governance model, a Social Responsibility Steering Committee was set up, members of which are the Board Director responsible for Corporate Social Responsibility, the OSHEP Centre, employee representatives and other departments.



Source: Hochtief Sustainability Report, 2007

4.5. EXAMPLES IN THE DISTRIBUTION SECTOR

J.Sainsbury, an example of sustainability governance that separates the execution from the supervision of sustainability in a clear and efficient manner

J.Sainsbury is a UK retail company. As a leader in the DJSI ranking in the “Food and Drug Retailers” sector, Sainsbury is an outstanding example in its understanding of the double function of the Board of Directors, i.e. the execution and the supervision of the sustainability agenda.

The Governance model includes a specialist committee of the Board of Directors, led by a Non Executive Director, who supervises the work of the Executive Directors in the sustainability area. It reports directly to the Chairman of the Board of Directors.

The company also has an organisational structure for the day to day execution of sustainability actions, which is a steering committee responsible for formulating and executing planned sustainability actions and objectives.

This committee is led by the CEO of the company and is made up of managers with responsibilities for each strategic priority of the company. Each of these managers also operationally leads work groups, which execute and control each strategic cornerstone of the

SAINSBURY GOVERNANCE FRAMEWORK



Source: <http://www.j-sainsbury.co.uk/cr/index.asp?pageid=21> [25/01/10]

company. In this way, the company meets the need to build a multi-disciplinary model which cuts across the entire organisation.

Sainsbury is also exemplary in demonstrating how it applies the corporate values that it has adopted in its governance structure. Each representative of the Steering Committee is responsible for managing and implementing these values through specific and measurable actions.

This sustainability governance model involves the people

with the most responsibility for the management and supervision of the company, making a clear distinction between those who manage and those who supervise, putting the CEO and leader of the company in the front line for the execution of the sustainability strategy.

With this model, Sainsbury has managed to achieve results and earned visibility by becoming the DJSI leader in 2008, in direct competition with the biggest retail operators in the world, providing proof of the effectiveness of the company’s sustainability performance.

4. STAKEHOLDERS EXPECTATIONS AND THEIR INTEGRATION INTO GOVERNANCE MODELS

30 | 31

Carrefour – sustainability in the core business means sustainability at the Board of Director’s level.

Carrefour is the biggest European retailer and the second biggest in the world. This global giant is one of the companies in the DJSI with the highest rankings in sustainability investment.

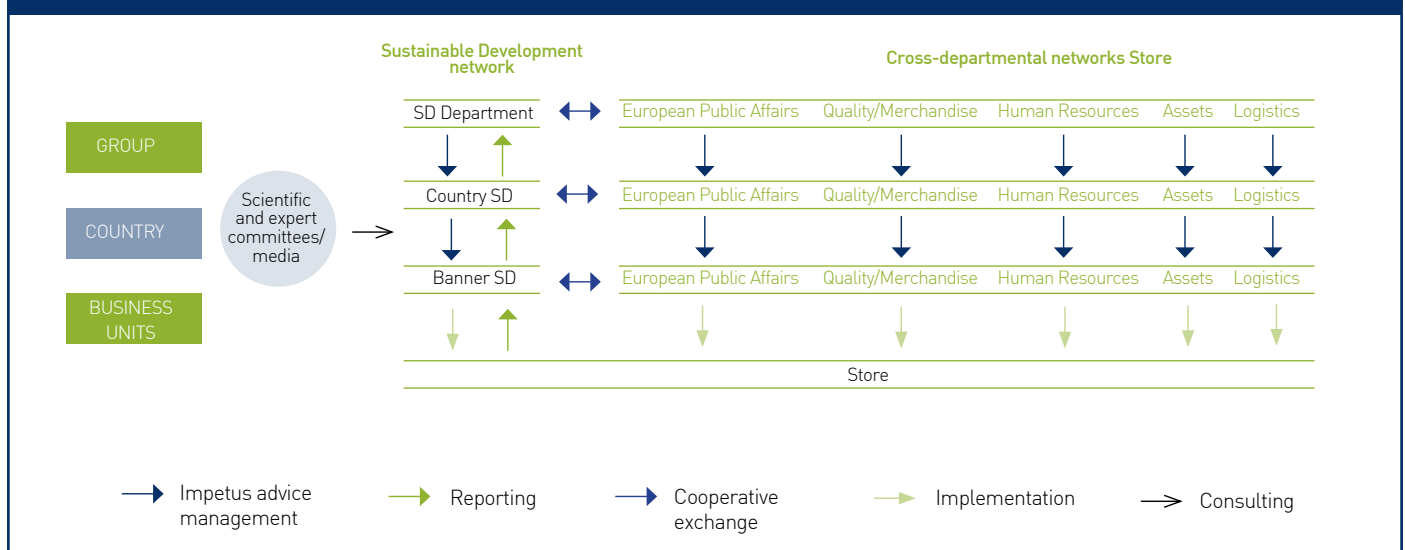
In relation to the supervision and execution of sustainability, Carrefour does not separate this area from any other, preferring not to focus its supervision exclusively on a specialist committee of the Board of Directors. Carrefour believes that the link between sustainability strategy and business strategy should be seamless and thus sustainability matters should be supervised and discussed both by the Executive Committee and by the Board of Directors.

The Executive Committee reviews this area with the Sustainable Development Department, which has the responsibility to communicate the strategy defined by the Board of Directors to all countries in which the country operates. Also at Group level, the department is responsible for meeting and reviewing with all Group departments, which have responsibilities for actions connected with the sustainability strategy.

The Sustainability Department has a representative in each country and in each store. This representative coordinates with store and department managers the implementation, adaptation and development of specific local objectives, which result from the general guidelines decided upon by the Board of Directors.

CARREFOUR SUSTAINABLE DEVELOPMENT ORGANIZATION AND POLICY

ORGANISING SUSTAINABLE DEVELOPMENT INITIATIVES INVOLVES ALL ACTIVITIES



Source: <http://www.carrefour.com/cdc/responsible-commerce/our-organization-and-policy/>

The company thus communicates the principles, policies and actions decided upon concerning sustainability across the entire organisation.

With this Sustainability Governance model, the company puts the Sustainable Development Department in a position to play a pivotal role at a corporate level, and at the management level of each country and even at

the level of each store of the Group, thus ensuring the cross company impact necessary for the effective implementation of sustainability.

5. FINAL THOUGHTS AND REFLECTIONS

The subject of corporate governance is no longer limited to the legal issues with which companies are obliged to comply, such as their statutes, legislation in force and regulatory requirements.

The approach chosen to manage the company can reveal the manner in which Directors and Shareholders see their role in society: if the objective of the company is merely to maximise profit, or maximise wealth for society in general, or if it continues to be the maximisation of a new definition of profit, which includes maintaining the long term licence of the company to operate. Before the company decides the functional system for its governance structure, it perhaps makes sense to reflect upon the objectives of the Vision, Mission and Values of the company. With this exercise completed, then a coherent theoretical governance model can be chosen between the Shareholder, Enlightened Shareholder and Stakeholder Models. The next step is to transpose these concepts into the practical working tools of the different governance systems, which can also be chosen or inspired by the Latin/Strengthened Latin, Anglo Saxon or German Model. Despite these definitions it is not possible to identify directly which of these systems is used by each of the PS120 listed companies, in which in some cases a mixture of various systems exist.

Since it can be assumed that the majority of PS120 companies use the Latin/Strengthened Latin Model, in which there is no explicit distinction between the Board of Directors and Executive Board, it can be inferred that some lack of supervision exists in the management of the majority of PS120 companies. It also signifies that currently there exists a lack of effective mechanisms which guarantee that the interests of shareholders are duly taken into account by the Board of Directors. This last statement makes more sense in the case of companies

with highly fragmented share capitals.

In Portugal, and due to its history, culture and open market economy which has developed only relatively recently, many PS120 listed companies still have strong family structures and so their share capital is not distributed among so many shareholders. Given this reality in Portugal, it is not surprising that governance practices of Portuguese companies are so different from those considered as good international practices. This could also signify that those PS120 companies, which seek to become part of the DJSI, would have to significantly change their governance systems. It is for this reason that PT and EDP are two companies which have a number of practices that can be considered as good governance (in spite of the ever polemical question of the "Golden Share"^[6]), with both of these companies having their share capital distributed among a very large number of shareholders. These good governance practices also cover issues related to sustainability. However, if the share capital of companies is in the hands of only one or two shareholders, this does not necessarily mean that they cannot have good sustainability practices. Rather it signifies that their governance practices, one of the cornerstones of sustainability, will not measure up to scrutiny according to existing international criteria. It is possible that these companies have good social and environmental practices, which meet society's expectations.

The pressure to change the governance cornerstone may arise if society begins to believe that minority shareholders should have more power in the decision making process, if the company wants to increase the fragmentation of share ownership in financial markets or if it wishes to become part of international investment fund portfolios. Regardless of the cultural differences between Portugal and other European and American countries, it is possible to find evidence that PS120 companies are integrating sustainability into their governance models. Despite the fact that 57% of PS120 companies state that they have a Sustainability strategy, only 43% recognise the Board of Directors as formally responsible for its management. And only 29% state in publicly disclosed documents that they have a Sustainability Committee, whereas in the DJSI this figure reaches 44%. This lack of direct involvement by the Board of Directors would explain the fact that only 33% of companies have a code of conduct relating to conflicts of interest and only 10% (2 companies) have codes of conduct for public lobbying and sexual harassment. Only 43% have an ethics code. These figures lead us to the conclusion that sustainability issues need to be incorporated and given due importance in the Boards of Directors of listed companies.

[6] Golden Share: Is a nominal share which is able to outvote all other shares in certain specified circumstances, often held by a government organization, in a government company undergoing the process of privatization and transformation into a stock-company.

6. RECOMMENDATIONS

It is likely that shareholders will become more vigilant and increase their control and supervision over management, especially in relation to the treatment and involvement of other stakeholders, who can also have a significant impact on financial results and the reputation of the company.

This implies that companies must accelerate the implementation of an organisational structure and governance model in line with the Enlightened Shareholder Model.

For this, we can expect companies to develop and implement measures that will ensure the adequate supervision and execution of sustainability actions, thus embracing the concept of Governance for Sustainability.

In order for the company to have a coherent approach at different levels of management, we recommend:

- Carrying out a review of its Vision, Mission and Values in the light of the new challenges presented by society.
- Identifying at all organisational levels the company's main stakeholders and the related impacts resulting from the relationships established between them and the company.
- Developing a functional governance model which is coherent with the company's Vision, Mission and Values.

In order for the Board of Directors to carry out its role of supervising sustainability, we recommend:

- Implement a Governance Model that can evaluate and advise executive management of the company about the principles, policies, commitments and actions that need to be taken to meet the expectations of shareholders and of society in

relation to Sustainable Development and Corporate Responsibility;

- Have a sufficient number of Non Executive Board Directors with the knowledge and experience to evaluate and challenge executive management regarding the implementation of all actions in the area of sustainability;
- Set up mechanisms and communication channels which make sufficient and necessary information available to Non Executive Board Directors to evaluate sustainability management in the organisation;
- Separate the powers of supervision and execution at all hierarchical levels of the organisation in order to provide relevant and independent information about the company's results (e.g. Internal audits, Inspections, Information systems, whistle blowing, etc)

For the Board of Directors to carry out its role of creating and executing a coherent sustainability strategy, it must:

- Formally make a clear commitment in relation to social, environmental and ethical issues, and identify a set of specific goals, which also reflect society's expectations;
- Create or adopt company standards which communicate succinctly the organisation's commitment to sustainable development
- Build a strategic and differentiating strategy for Sustainable Development, which reduces social, environmental and economic risks with the potential to impact the present and future performance of the company, and /or takes advantage of the economic, social and environmental opportunities that have the potential to maximise the present and future performance of the company;
- Develop a structured and intensive internal and external stakeholder dialogue, leading towards the set up of external stakeholder panels, which interact directly with the BoD.
- Adopt a sustainability organisational structure that involves the main leaders of the company and those responsible for both the positive and negative impacts of the company, which will maximise the effectiveness of the implementation of sustainability in the organisation;
- Build management controls and procedures that allow the results of sustainability management in the organisation to be evaluated and communicated.

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8. ANNEX 1 – VARIABLES USED IN THE ANALYSIS

REFERENCES USED TO IDENTIFY THE VARIABLES CHOSEN

- SAM
- KING REPORT
- PORTUGUESE RECOMENDATIONS
- PORTUGUESE LEGISLATION
- UK COMBINED CODE
- GRI




















BOARD	ONE - TYER SYSTEM . N° Independent directors . N° Non-executive directors . N° Executive directors	yes/no N° N° N°	● ● ● ● ●
	OR		
	TWO TYER SYSTEM . N° Independent directors . N° Non-executive	yes/no N° N°	
	WOMEN . N° Women	yes/no N.º	
MANAGEMENT BOARD	Executive management (yes/no)	yes/no	
	N° executive directors	N°	

CHAIRMAN	CEO and Chairman	yes/no	
	Chairman is Independent	yes/no	●
	Chairman is Non-executive	yes/no	● ●
	Chairman is Executive	yes/no	
	Chairman is former CEO	yes/no	

BOARD FORMAL RESPONSIBILITY	Strategy	yes/no	
	Risk	yes/no	
	Auditing	yes/no	
	Selection, nomination and reward of executive, non-executive and independents	yes/no	● ● ●
	Compliance with current legislation and internal norms	yes/no	
	Corporate social responsibility, corporate citizenship, sustainable development	yes/no	
	Management monitoring and supervision	yes/no	

DISCLOSURE OF BOARD FORMAL PROCEDURES	Number of meetings last fiscal year	yes/no	● ●
	Corporate governance report	yes/no	
	Corporate Governance formal policy	yes/no	
	Members CVs and compliance with independency	yes/no	● ● ●
	Attendance of board of directors/ supervisory board meetings disclosed	yes/no	

8. ANNEX 1 – VARIABLES USED IN THE ANALYSIS

SHAREHOLDERS RELATIONS	Investors relations office (yes/no)	yes/no	  	FROM MISSION TO POLICIES	Mission refers to Sustainability issues (ESG factors)	yes/no	
	Formal procedures to shareholder engagement (yes/no)	yes/no			Values include Sustainability (ESG factors)	yes/no	
	Has a Minority Shareholders policy	yes/no			Business Principles include Sustainability (ESG factors)	yes/no	
	Proxy voting disclosure on Internet	yes/no	 		Deontological Code	yes/no	
	Number of votes per share (select one)	Nº			Code of Conduct	yes/no	
	1 to 1				Code of Conduct refers to Political Lobby	yes/no	
	1 to 100		 		Code of Conduct refers to sexual harassment	yes/no	
	other				Code of Conduct refers to human rights	yes/no	
	Number of meetings with shareholders	Nº			Code of Conduct refers to environment	yes/no	
ENTRENCHMENT PROVISIONS AT THE BOARD	Staggered (or classified) board	yes/no			Code of Conduct refers to sustainability	yes/no	
	Limits to amend by-laws: supermajority required	yes/no			Conflict of Interests code	yes/no	  
	Limits to amend charter: supermajority required	yes/no			Whistleblowing or formal mechanism in place to assure compliance, prudential risk and protect from conflict of interests	yes/no	 
	Supermajority required for mergers	yes/no			Independency requirements	yes/no	  
	Golden parachuts	yes/no					
	Poison pills	yes/no					

REMUNERATION, NOMINATION AND PERFORMANCE APPRAISAL PROCEDURES	Performance evaluations disclosure for all directors	yes/no	
	Framework and performance evaluation policy available	yes/no	●
	Remuneration policy disclosed	yes/no	●
	Nominations procedure disclosed	yes/no	●
	Remuneration based on sustainability performance	yes/no	
PORTUGUESE STOCK EXCHANGE GOVERNANCE RECOMENDATIONS (THEY HAVE A ANNUAL REPORT ON THIS ISSUE)	Nº of recommendations the company complies with	Nº	●
	Non-compliance recommendations	yes/no	

Methodological notes

All data used in the analysis refers to the year 2007. The data regarding the Portuguese companies was gathered on public available information. The data regarding the DJSI listed companies was supplied by SAM.

All quantitative analysis consider those listed companies in the PSI20 and DJSI in 2008. In the Portuguese case the analysis also includes an extra company – Impresa – since this company has left the PSI 20 in February 2008, but can be seen as having some good governance practices.



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