

An Overview of Brazilian Corporate Governance

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IBGC Annual Meeting

Dec. 8, 2008

Overall Project

- Study evolution of Brazilian corporate governance over time.
- Goal: Time series research on:
 - How do governance practices affect firm behavior and share value?
 - How do firm characteristics affect firms' governance choices?
 - Which “good governance” prescriptions matter, which don't?

Related research, mostly on “BRIC” countries (on SSRN, at www.ssrn.com)

- **Brazil:**
 - *Strengthening Brazil's Securities Markets*, 120 **Revista de Direito Mercantil, Economico e Financiero** 41-55 (2000)
- **Russia:**
 - Black, Cheffins, Gelter, Kim, Nolan, Siems & Linia Prava, *Report to Russian Center for Capital Market Development: Comparative Analysis on Legal Regulation of the Liability of Members of the Executive Organs of Companies* (2007)
 - Black, Love & Rachinsky, *Corporate Governance Indices and Firms' Market Values: Time-Series Evidence from Russia*, 7 **Emerging Markets Review** 361-379 (2006)
 - Black & Tarassova, *Institutional Reform in Transition: A Case Study of Russia*, in 10 **Supreme Court Economic Review** 211-278 (2003)
- **India:**
 - Balasubramanian, Black & Khanna, *Firm-Level Corporate Governance in Emerging Markets: A Case Study of India* (2008)
 - Black & Khanna, *Can Corporate Governance Reforms Increase Firms' Market Values? Event Study Evidence from India*, 4 **Journal of Empirical Legal Studies** 749-796 (2007)
- **Korea:**
 - Black & Kim, *The Effect of Board Structure on Firm Value: A Multiple Identification Strategy Approach Using Korean Data* (2008)
 - Black, Kim, Jang & Park, *How Corporate Governance Affects Firm Value: Evidence on Channels from Korea* (2008)
 - Black, Jang & Kim, *Does Corporate Governance Affect Firms' Market Values? Evidence from Korea*, 22 **Journal of Law, Economics and Organization** 366-413 (2006a)
 - Black, Jang & Kim, *Predicting Firms' Corporate Governance Choices: Evidence from Korea*, 12 **Journal of Corporate Finance** 660-691 (2006b)
- **Bulgaria:**
 - Atanasov, Black, Ciccotello & Gyoshev, *How Does Law Affect Finance? An Examination of Equity Tunneling in Bulgaria* (2008)

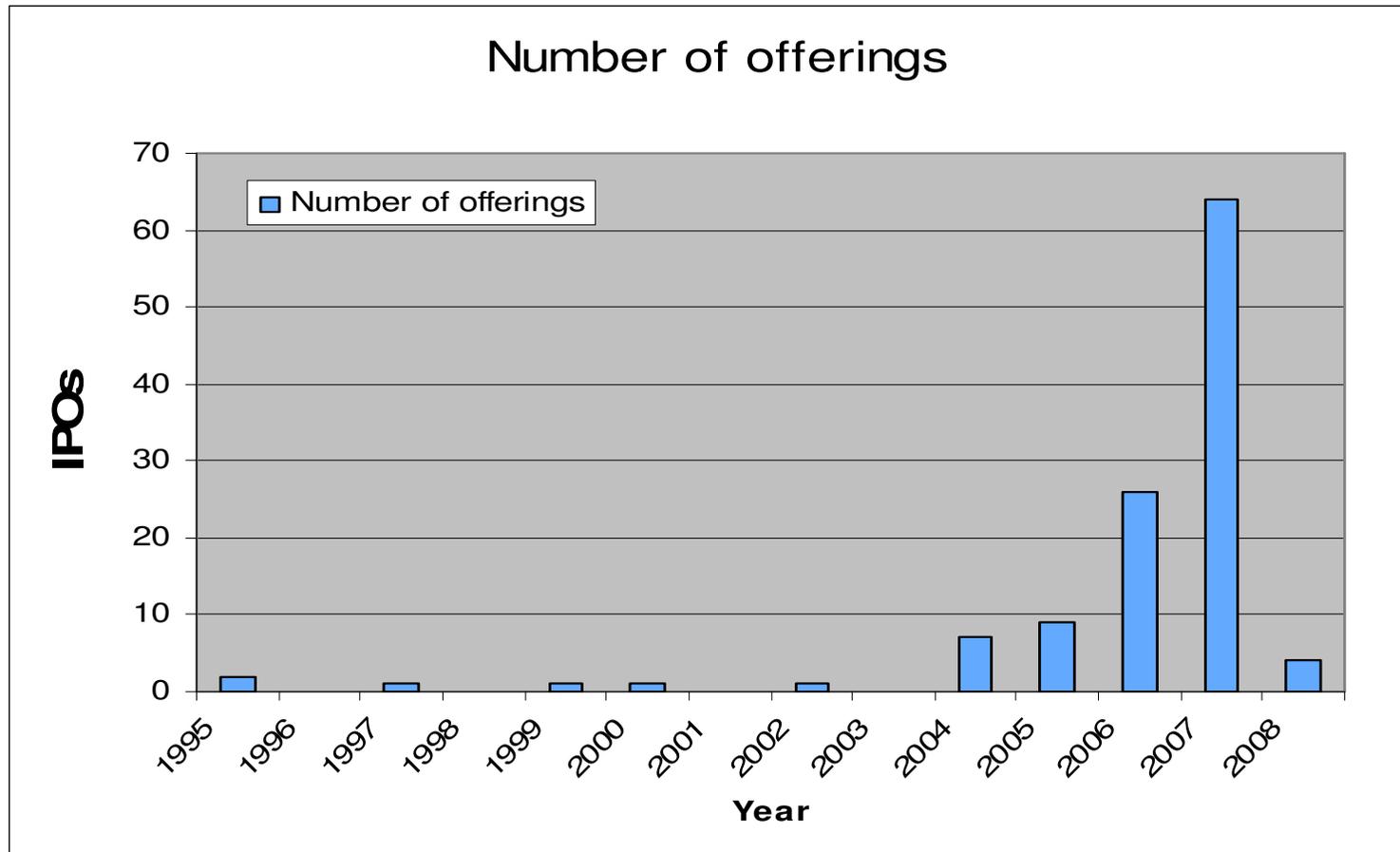
Ongoing Brazil CG Surveys

- 2005: 116 responding firms
- 2008: 171 responding firms
 - 2009: In planning (funds from GCGF)
- **Report results mostly from first survey**
 - Still analyzing second survey

Evolution of Brazilian Corporate Governance

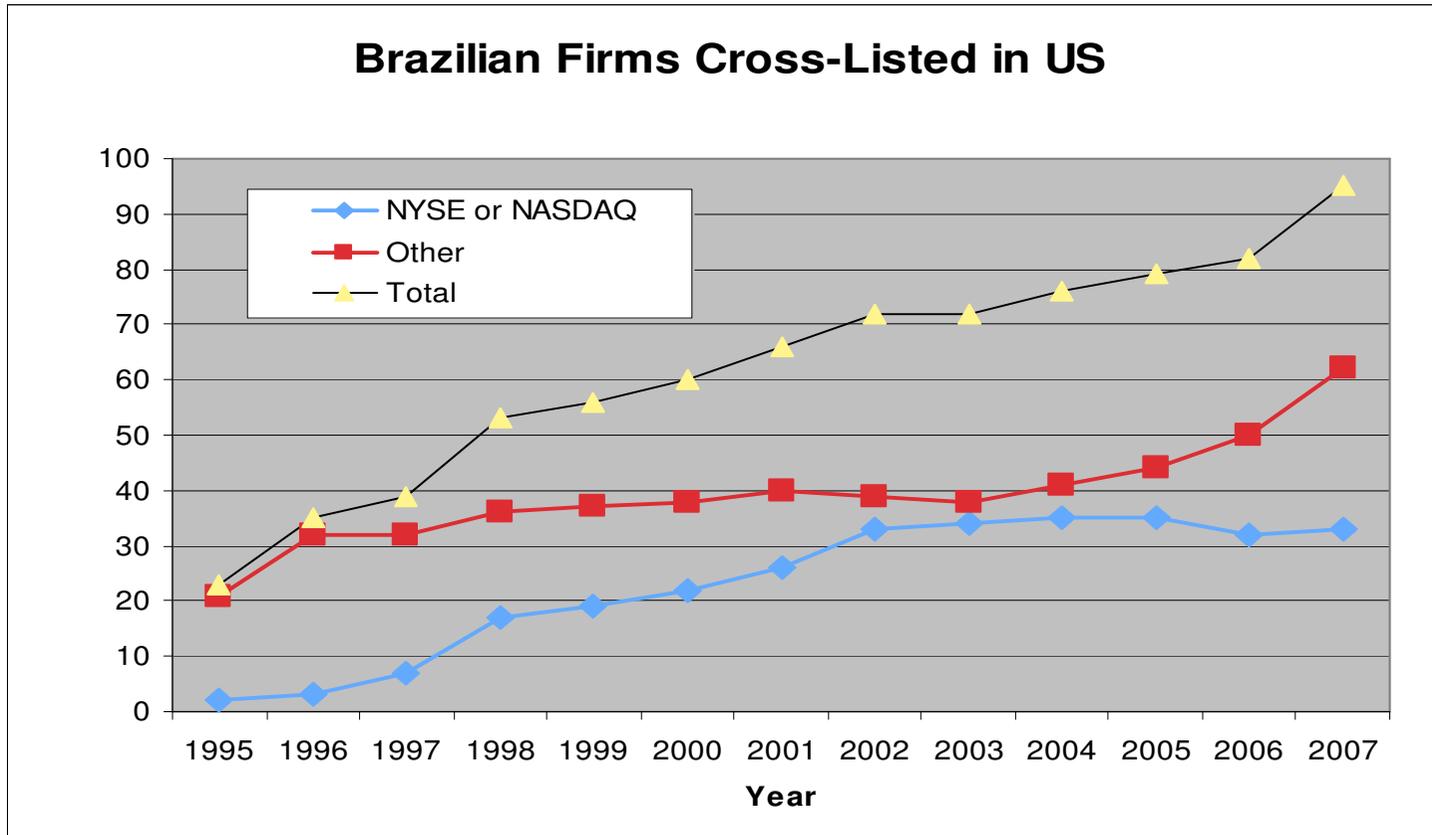
- History: weak public stock market
 - tax incentives to go public
 - firms didn't need public capital
 - little attention to minority shareholder rights
- Family control
 - outsiders get nonvoting preferred shares
- Rapid development since 2000
 - 2001 legal reforms
 - Bovespa: Novo Mercado, other listing levels
 - large number of IPOs
 - US cross-listings now mostly OTC or Portal

Brazilian IPOs



Something good is happening. Why?

Brazilian Cross-Listings in the US



First survey: Mostly a snapshot in early 2005

Responders versus all private firms

Quartile	Market cap (R\$ millions)	Firms	Responses	%	All firms in quartile	% of total	Responding firms	% of quartile
1	1,061 to 86,739	78	32	41.0%	515,919	92.6%	322,734	62.4%
2	172 to 991	78	24	30.8	35,151	6.3	12,478	35.5
3	20 to 158	78	21	26.9	5,592	0.3	1,666	29.9
4	0 to 19	79	11	13.9	465	0.1	54	11.6
	Total	313	88	28%	557,128	100%	336,933	60.5%

Of 116 responding firms:

- 17 government controlled
- 11 foreign controlled
- 88 private firms

We focus on private firms

- **63% of market cap of actively traded firms**

Board Size and Composition

- Average board is small:
 - mean = 6.78
 - median = 6
- Independent directors
 - Board must be $\leq 1/3$ *officers*
 - No legal requirement of *independence*
 - Novo Mercado or Nivel 2 = 20%
- Let's see what firms are doing . . .

Board Composition

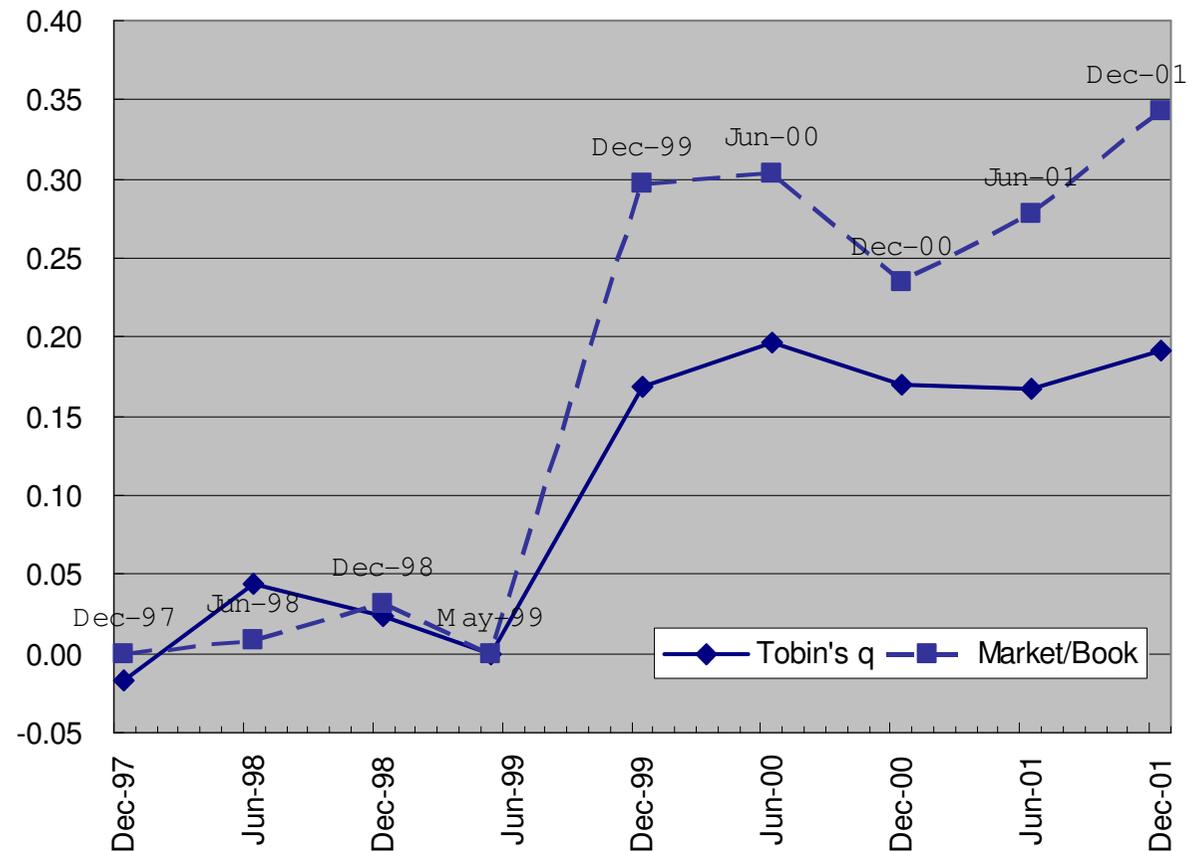
(n = 80 private firms with data on board composition)

Independent Directors	number of firms	cumulative % of firms	% Independent Directors	number of firms	cumulative % of firms
0	28	35%	0	28	35%
1	14	53%	1-10%	1	36%
2	16	73%	11-20%	12	51%
3	13	89%	21-30%	7	60%
4	5	94%	31-40%	15	78%
5	0	94%	41-50%	9	89%
6	4	99%	51-60%	4	95%
7	1	100%	61% or more	4	100%
mean	1.65		mean	24%	
median	1.00		median	20%	

One-third of firms have 0 independent directors
 one-half have 0 or 1 independent directors

Korea evidence

- 1999 law requires large firms (assets > 2 trillion won, about US\$ 2 billion) to have 50% outside directors; audit committee; outside director nominating committee
- Large versus small firms (from Black & Kim, 2008):



Board processes

Selected Board Processes	Yes	% Yes
Regular system for evaluating the CEO	28	32%
Succession plan for the CEO	15	21%
Bylaw to govern board activity	48	55%
Zero board meetings in last year	2	2%
0-3 board meetings in last year	7	8%
Independent directors can obtain outside advice at company's expense	7	14%
Annual meeting exclusively to independent directors	1	2%

Audit committee and fiscal board

		Permanent Fiscal Board	
		Yes	No
Audit committee	Yes	8%	9%
	No	31%	52%
Total		39%	61%

But: many firms with no permanent fiscal board (24/52) have semi-permanent fiscal board (appointed in 4-5 of last 5 years).

- 68% have audit committee or semipermanent fiscal board
- 22% have occasional fiscal board (1-3 times in last 5 years)
- 10% have fiscal board during last 5 years.

Related Party Transactions

Disclosure	Yes	%
Significant RPTs disclosed to shareholders	59	69%
Approval (transaction with controller)		
No special approval	15	17%
Approval by the board of directors	56	65%
Approval by nonconflicted directors	10	12%
Approval by shareholders	11	13%
Approval by nonconflicted shareholders	8	9%

Room for improvement here.

Disclosure and approval by non-conflicted directors should be a minimum.

Large transactions should require approval by non-conflicted shareholders.

Compare Russian company law (Black & Kraakman, 1996)

Control

Type of control	No. of firms	%
single shareholder	20	24%
another non-public company	16	19%
another public company	5	6%
family	10	12%
group of shareholders	30	35%
other	3	4%
no controlling shareholder or group	1	1%

Maybe 15 firms with no majority control today (mostly new firms)
For dispersed control, need minimum protection of minority shareholders.
Is Brazil approaching that point today?
If so, what is changing?
Role of Novo Mercado

Conclusions

- More details in our paper on:
 - auditor independence
 - board practices
 - audit committee and fiscal board
 - rights of preferred and common rights
- Rapid changes in Brazilian corporate governance
 - Hope to continue survey annually
 - Highlight governance strengths and weaknesses
 - Inform policy choices, in Brazil and elsewhere