The Corporate Governance of Privately Controlled Brazilian Firms

Bernard S. Black*
Antonio Gledson de Carvalho**
Érica Gorga***

Abstract

We provide an overview of the corporate governance practices of Brazilian public companies, based primarily on an extensive 2005 survey of 116 companies. We focus on the 88 responding Brazilian private firms which are not majority owned by the state or a foreign company. We identify areas where Brazilian corporate governance is relatively strong and weak. Board independence is an area of weakness: The boards of most Brazilian private firms are comprised entirely or almost entirely of insiders or representatives of the controlling family or group. Many firms have zero independent directors. At the same time, minority shareholders have legal rights to representation on the boards of many firms, and this representation is reasonably common. Financial disclosure lags behind world standards. Only a minority of firms provide a statement of cash flows or consolidated financial statements. However, many provide English language financial statements, and an English language version of their website. Audit committees are uncommon, but many Brazilian firms use an alternate approach to ensuring financial statement accuracy – establishing a fiscal board. A minority of firms provide takeout rights to minority shareholders on a sale of control. Controlling shareholders often use shareholders agreements to ensure control.

***Keywords*:** Brazil; corporate governance; boards of directors; minority shareholders.

JEL codes: G18; G30; G34; G39; K22; K29.

Resumo

Este artigo apresenta um panorama das práticas de governança corporativa no Brasil, baseado em um extenso levantamento feito no ano de 2005 com 88 empresas com controle privado nacional. Identificamos áreas no Brasil, onde a governança corporativa é relativamente forte ou fraca. Os conselhos de administração da maioria das empresas privadas brasileiras são compostos totalmente ou quase totalmente por membros ou representantes da família ou grupo controlador. Muitas empresas não têm nenhum conselheiro indepen-

Submitted in May 2009. Accepted in September 2009. Article was double blind referred and evaluated by the editors. Supervising editor: Ricardo P. C. Leal. We thank Ricardo P. C. Leal for comments; Humberto Gabrielli, Handemba Mutana Poli dos Santos, Joelson Sampaio, Luiz Fernando Conde Bandini, Rodrigo Tolentino, and Viviane Werneck for research assistance; and Bovespa, CVM, and IBGC for their support of the corporate governance survey on which this article is based. We thank the Global Corporate Forum and Direito GV for financial support.

*University of Texas at Austin, Law School and McCombs Business School.
E-mails: bblack@law.utexas.edu / bblack@northwestern.edu
**Fundação Getulio Vargas School of Business at São Paulo. E-mail: gledson.carvalho@fgv.br
***Fundação Getulio Vargas Law School at São Paulo (Direito GV). E-mail: erica.gorga@fgv.br

Revista Brasileira de Finanças 2009 Vol. 7, No. 4, pp. 385–428
ISSN 1679-0731, ISSN online 1984-5146

dente. Ao mesmo tempo, acionistas minoritários têm direitos de representação no conselho de administração de muitas empresas, e tal representação é razoavelmente comum. Divulgações de informações financeiras estão aquém dos padrões internacionais. Apenas algumas empresas fornecem informações sobre os fluxos de caixa ou demonstrações financeiras consolidadas. Entretanto, muitas empresas fornecem suas demonstrações financeiras em inglês em seu *website*. Comitês de auditoria não são comuns, porém muitas empresas brasileiras buscam uma alternativa para assegurar a precisão das demonstrações financeiras, através da criação de um conselho fiscal. Uma pequena parte fornece direitos de proteção para os acionistas minoritários em uma venda de controle da empresa. Os acionistas que detém o controle da empresa costumam utilizar acordos de acionistas para garantir o controle.

***Palavras-chave*:** Brasil; governança corporativa; conselho de administração; acionistas minoritários.

1. Introduction

This paper provides an overview of Brazilian corporate governance in early 2005. It is based primarily on an extensive survey distributed to all firms listed on Bovespa, Brazil's principal stock exchange (2005 Brazil CG Survey). We received 116 replies to the survey, including 88 from privately controlled firms, 17 from government-controlled firms and 11 from subsidiaries of foreign companies. This paper focuses on privately controlled firms.

Our data provide a uniquely detailed snapshot of Brazilian corporate governance. Even basic data, such as the number of independent and non-independent directors, was previously not available. We identify areas where Brazilian corporate governance is relatively strong and weak. Board independence is an area of weakness: The boards of most Brazilian private firms are comprised entirely or almost entirely of insiders or representatives of the controlling family or group. Many firms have zero independent directors. At the same time, minority shareholders have legal rights to representation on the boards of many firms, and this representation is reasonably common. Financial disclosure lags behind world standards. Only a minority of firms provide a statement of cash flows or consolidated financial statements. However, many provide English language financial statements and an English language version of their website. Audit committees are uncommon, but many Brazilian firms use an alternate approach to ensuring financial statement accuracy – establishing a fiscal board. A minority of firms provide takeout rights to minority shareholders on a sale of control beyond the minimum required by Brazilian law. Controlling shareholders often use shareholders agreements to ensure control.

This paper proceeds as follows. In Section 2, we briefly review the general literature on corporate governance in emerging markets, and provide a more detailed review of Brazilian corporate governance. In Section 3 we describe our survey, other data sources and sample. Section 4 discusses the overall size of the Brazilian public market, and the cross-listing and Bovespa listing choices made by Brazil-

ian firms. The remainder of this article concentrates on Brazilian private firms and covers boards of directors (Section 5); board and committee procedures (Section 6); audit committee, fiscal board and independent auditor (Section 7); shareholder meetings and shareholder rights (Section 8); conflict of interest transactions (Section 9); financial disclosure (Section 10); control and shareholder agreements (Section 11); and compensation (Section 12). Section 13 concludes.

2. Literature Review

We review here the limited literature on corporate governance patterns in emerging markets. We cover studies of Brazil with care, and other studies in less depth. We do not cover studies of developed countries or nonpublic firms.

2.1 Firm-level governance in emerging markets

This paper provides a detailed descriptive analysis of firm-level governance in an important emerging market. We know remarkably little about those details. Cross-country studies of governance often provide high level comparisons between countries – for example, mean scores on disclosure (Patel et alii, 2002) or overall governance (Bruno e Claessens, 2006). Moreover, these studies rely on a limited set of cross-country governance measures. The available multi-country measures which cover emerging markets are:

- Standard & Poor's transparency and disclosure survey (conducted in 2002, repeated in selected countries but not generally) – covers 30 Brazilian companies.
- Credit Lyonnais Securities Asia governance survey (conducted in 2001, not repeated) – covers 24 Brazilian companies.[1]

Individual country studies typically report summary statistics for overall governance and particular governance measures (e.g., Zheka (2006), Ukraine; Drobetz et alii (2004), Germany; Black et alii (2006), Russia). Choi et alii (2007) provide some details on the composition of Korean boards of directors during 1999-2002. But there is very little that provides a fine grained picture of a particular country. The only comparable study we know of is a contemporaneous study of India (Balasubramanian et alii, 2009).

2.2 Research on brazilian corporate governance

Overall governance

We survey here what we consider to be the more significant research on Brazilian corporate governance. Leal (2007) provides a more extensive survey. Valadares e Leal (2000) and Leal et alii (2000) find a high degree of concentration of

[1] Baker et alii (2007) report results from an index developed by Alliance Bernstein, which includes Brazil (number of firms not stated), but provide too few details on the index elements for us to assess its reliability.

voting power in Brazilian firms. This concentration is due in large part to firms using dual-class structures, with insiders retaining voting common shares and outsiders holding primarily nonvoting preferred shares.

Da Silveira et alii (2009) study the evolution of firm-level corporate governance practices in Brazil from 1998 to 2004 using a broad corporate governance index based on publicly available data. They find that overall governance quality improved over this period, but remains low. There are large differences between firms, with greater heterogeneity over time. They found no significant explanatory factors for firms' governance choices.

Dutra e Saito (2002) study the effect of cumulative voting on board composition as of 2000 for the 142 most actively traded Brazilian firms. They rely on family names to identify which directors may be independent. They find little use of cumulative voting, and estimate that about 20% of directors are independent.

Da Silveira et alii (2004) study the association between firm value and board size, composition, and separation of Chairman and CEO. They find a positive association between separation of Chairman and CEO and Tobin's q.

Novo mercado

De Carvalho (2000) reviews Brazil's experience during the 1990s and concludes that the absence of IPOs, and the decline in trading on Bovespa during the late 1990s, is plausibly related to low investor protection. This study formed part of the basis for Bovespa's creation of Novo Mercado in 2000.

De Carvalho (2002) discusses the potential value of higher governance listing segments of an overall stock market, such as those introduced by Bovespa. De Carvalho e Pennacchi (2009) analyze firms' decisions to go public on, or migrate to, the higher Bovespa listing levels, and find evidence of lower IPO underpricing, positive investor share price reaction to migration, and higher post-migration liquidity.

Bovespa's success with higher listing levels has led to efforts to copy its approach in, to our knowledge, Turkey and Romania, though thus far with little success (Alexandru, 2008, Ararat e Burcin Yurtoglu, 2007).

Takeout rights

Several papers study takeout rights (also called tag along rights) in Brazil. Many Brazilian firms issue both voting common shares and nonvoting preferred shares, which have economic rights similar to common shares. Prior to 1997, Brazilian corporate law required a new controlling shareholder, who acquired 50% of the common shares, to offer to buy all remaining common shares, at the same per-share price paid for when acquiring control. In 1997, Brazil removed this rule to facilitate the government's sale of controlling stakes in majority state-owned enterprises. In 2000, the law was changed again, to reinstate takeout rights for common shares at 80% of the per-share price paid for the controlling shares. Nenova (2005) and Carvalhal-da-Silva and Subramanyam (2007) report conflicting results

on how these law changes affected the premium accorded to common shares, relative to preferred shares. Bennedsen et alii (2008), report that during 2000-2006, a number of Brazilian firms voluntarily agreed to provide additional takeout rights to common shareholders, provide takeout rights to preferred shareholders, or both, in connection with equity offerings.

Value of control

Dyck e Zingales (2004) study the premium paid for control blocks in 39 countries; of these, Brazil had the highest average premium, at 65% of the trading value of the shares. Nenova (2003) estimates that Brazil had a relative high value of control, at 23% of firm value; values for other countries range up to 48% in South Korea. See also Valadares (2002).

2.3 Overview of brazilian corporate governance

Historically, Brazilian financial markets were heavily regulated.[2] Brazil adopted its first Corporations Law only in 1940. The government ran the stock exchanges. Brokers were civil servants, who had the exclusive right to trade shares on the exchanges, and could pass this right on to their children. Government rules specified the number of brokers in each area, as well as brokerage fees.

Some financial liberalization began after a 1964 military coup. In 1965, the new government adopted the first law to regulate capital markets and securities offerings (Law 4728/65). The Brazilian securities commission, Comissão de Valores Mobiliários (CVM), was created in 1976 (Law 6385/76). A new Corporations Law, also enacted in 1976, established separate rules for closely held and public corporations (Law 6.404/76). These reforms eliminated the old civil servant brokers and permitted private stock exchanges and broker-dealers to emerge.

During the 1970s and 1980s, the government took several steps to encourage stock market development. It granted tax incentives to firms that went public and to investors who purchased shares in public companies, and required pension funds and insurance companies to invest a minimum percentage of their assets in the shares of public companies. By the end of the 1980s, there were almost 600 publicly traded companies, but a significant number had gone public only to capture the tax incentives, and had no interest in having public shareholders or active trading of their shares.

In the late 1980s, the financial incentives for going public were eliminated; since then, many of the firms which went public during the period of tax incentives have returned to private ownership. At the same time, the government partially or fully privatized a number of state owned enterprises. By the end of the 1990s, a large fraction of share trading involved shares of privatized companies. Many large Brazilian firms cross-listed on the New York Stock Exchange (NYSE), and a significant portion of trading moved to the NYSE. Privatizations aside, there were almost no IPOs, and the number of public firms shrank.

[2] For further discussion of the history of Brazilian corporate law and governance, see Gorga (2006).

Meanwhile, in the 1980s, the Rio de Janeiro Stock Exchange collapsed, leaving the Sao Paulo Stock Exchange, Bovespa, as the principal share trading market. The remaining exchanges merged into Bovespa in 2000 (Santana, 2008). The Instituto Brasileiro de Governança Corporativa (Brazilian Institute for Corporate Governance, or IBGC) was created in 1995, and released an initial Code on the Best Practices of Corporate Governance in 1999. In 2000, Bovespa launched three new listing segments, Level 1, Level 2 and Novo Mercado, with stronger requirements for corporate governance than for a regular Bovespa listing (Santana, 2008). We discuss the market success of these higher listing levels below. CVM issued its own Recommendations on Corporate Governance in 2002. These are pure recommendations, there is no *comply or explain* regime, in contrast to a number of other countries.

3. Survey Methodology and Sample

3.1 Survey methodology

This study draws mainly on our early 2005 survey of all Brazilian companies with shares listed on Bovespa. Respondents could complete the survey either in paper form or by using a web interface. The survey was conducted with support from Bovespa, which distributed the survey to member firms. We followed up with each firm through repeated phone calls and emails. We promised confidentiality to all respondents, and thus do not name individual firms in this paper. We received 116 responses, for a response rate of 32%.[3]

3.2 Data sources

We use several data sources in addition to the survey responses. The list of publicly traded companies is from Bovespa, at `www.bovespa.com.br/principal.asp`. Market capitalization comes from Bovespa. Financial data comes from the Brazilian financial database Economatica, available at `www.economatica.com`. Basic company information comes from annual reports, available from the InfoInvest Database at `www.infoinvest.com.br`. Information on Bovespa listing levels and date comes from Bovespa. Information on cross-listing exchanges, levels, and dates comes from Bank of New York, at www.adrbny.com, CVM, at `www.cvm.gov.br`, Deutsche Bank, at `www.adr.db.com`, Citibank, at `wwss.citissb.com/adr/common/linkpage.asp?linkFormat=M\&pageId=5\&subPageId=40`, and JP Morgan, at `www.adr.com` (we reconciled discrepancies between these sources by contacting companies directly).

3.3 Sample description

Table 1 provides basic information on all publicly traded Brazilian firms, firms with at least somewhat active trading (the firm's shares traded, on average, at least

[3]The survey (in Portuguese) and an English translation are available from the authors on request.

once every two weeks), and the firms which responded to the survey. As of January 2005, Bovespa included 358 firms with publicly traded shares. We sent the survey to all of these firms, and received 116 responses (32%), including a 71% response rate from government-controlled firms, and a 52% response rate from subsidiaries of foreign companies, but only a 28% response rate from *Brazilian private firms* (firms without majority government or foreign ownership). However, measured by market capitalization, the response rate for Brazilian private firms is much stronger. By this measure, we capture 61% of the market capitalization of Brazilian private firms. If we limit to actively traded firms, the response rate improves, to 38% overall, 34% for Brazilian private firms, and 63% for private firms based on market capitalization.

It is likely that governance characteristics differ between our three groups of firms – Brazilian private firms, government-controlled firms, and subsidiaries of foreign firms. We focus in this paper on Brazilian private firms. The tables below are limited to these firms, unless otherwise specified. We have 88 responses from private firms. However, two firms answered only the first part of the survey. Thus, for many questions, we have 86 responses instead of 88. For particular questions, we also have occasional missing or ambiguous responses, these are noted below.

Table 1
Sample characteristics: all firms and responding firms

Total number of firms and market capitalization for (i) all publicly traded Brazilian firms, (ii) firms with active trading (trading on at least 26 days during 2004), and (iii) firms which responded to the 2005 Brazil CG Survey, separated into firms with Brazilian private control, state control, and foreign control. Data is as of January 2005. Exchange rate as of December 31, 2007 is R$1.80 per US$1

Number of firms	All public firms	Responding firms	Percent	Actively traded firms	Responding firms	Percent
All firms	**358**	**116**	**32%**	**229**	**87**	**38%**
Private	313	88	28%	194	66	34%
State	24	17	71%	19	14	74%
Foreign	21	11	52%	16	7	44%
Market cap (R$ billions)						
All firms	**871**	**441**	**51%**	**833**	**433**	**52%**
Private	557	337	61%	523	332	63%
State	167	51	31%	165	50	30%
Foreign	147	54	36%	144	51	35%

Table 2 provides a breakdown of Brazilian private firms by market capitalization quartile. The top quartile of firms by size represent 93% of the market capitalization of all Brazilian private firms, while the bottom half of firms are quite small and together represent only 0.4% of market capitalization. The largest private firm by market capitalization (Vale do Rio Doce) has twice the market value of the entire bottom three quartiles. Many of these firms have very limited trading, and perhaps should not be considered as public firms at all.

Our response rate was substantially higher for actively traded firms, and for larger firms. The response was 41% for the quartile containing the largest private firms. Moreover, even within the top quartile, responding firms tended to be larger than nonresponding firms. For example, we received responses from 21 of the

39 firms in the top octile of firms. As a result, responding firms include 61% of the market capitalization of all Brazilian private firms. Measured by market capitalization, then, our sample is reasonably representative of the Brazilian stock market.

Table 2
Sample characteristics: Brazilian private firms, by size quartile

Total number of firms and market capitalization for Brazilian private firms which responded and did not respond to the 2005 Brazil CG Survey, divided into quartiles based on market capitalization. Market capitalization is in R$ millions. Data is as of January 2005. Exchange rate is R$2.62 per US$1

Quartile	Size range in millions of reais	Number of firms			Market capitalization			
		Total	Responding firms	Responding as % of quartile	All firms in quartile	% of total	Responding firms	Responding as % 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	28.1%	557,128	100%	336,933	60.5%

4. Listing Levels: Bovespa and Cross-Listing

In 2000, Bovespa sought to respond to Brazil's image (and perhaps substance) of having poor corporate governance, by creating a family of voluntary listing levels, with increasingly strict corporate governance requirements. This experiment with higher listing levels was patterned after the *Neuer Markt*, created by Deutsche Borse. The higher levels provided investors with a readily understood signal of their corporate governance posture. The Neuer Markt failed and was reabsorbed into the overall Frankfurt exchange.[4] In contrast, the Bovespa effort, after a slow start, has become a major success. Bovespa listing levels now include *regular* Bovespa, Level 1, Level 2, and Novo Mercado (New Market).[5]

Many Brazilian firms issue both common shares and nonvoting preferred shares, which are similar in their economic rights to nonvoting common shares. A Novo Mercado listing requires, among other things, that the firm issue only voting common shares; have a minimum free float (shares not controlled by the controlling shareholders) of 25%; provide financial statements which comply with U.S. GAAP or IAS; provide full takeout rights to minority shareholders in a transfer of control; and agree that conflicts with shareholders will be resolved by arbitration. Level 2 is similar to Novo Mercado, but allows firms to issue preferred shares. Level 1 is only a small step up from an ordinary listing, and focuses on improved disclosure. In 2006, Bovespa created Bovespa Mais, intended for smaller firms, with somewhat lower listing requirements than Novo Mercado, but this level has only one company listed. An appendix summarizes the Bovespa rules for Regular, Level 1, Level 2, and Novo Mercado listings.

Cross-listing provides another way for Brazilian firms to signal their intent to maintain a higher level of disclosure and other corporate governance practices. Ta-

[4]For further details, see De Carvalho e Pennacchi (2009).

[5]The full name on Bovespa for Level 1 (2) is Differentiated Level of Corporate Governance 1 (2).

ble 3 summarizes the Bovespa and foreign cross-listing decisions of the responding Brazilian private firms at the date of our survey. Nineteen firms in our sample (22%) have cross-listed their shares. Most firms which cross-list shares do so only for nonvoting preferred shares. Three firms in our sample are listed on Bovespa Level 2, and two are listed on Novo Mercado.

Table 3 offers a snapshot of cross-listing and Bovespa listing in the first half of 2005. But this picture has been changing rapidly. From 1995-2003, there were only six initial public offerings by Brazilian firms – an average of less than one per year. The number of IPOs then soared to 7 in 2004; 9 in 2005, 26 in 2006, and 64 in 2007. In 2008, there were 4 IPOs. Of these 110 IPOs, 78 were on Novo Mercado, 15 on Level 2, 8 on Level 1, 1 on Bovespa Mais and 8 (all cross-listed firms) had a regular listing. The ANBID (Association of Brazilian investment banks) bars member firms from participating in an offering unless the firm is listed on Level 1 or higher; there is an exception for cross-listed firms, which are not eligible for Level 1 or higher listing levels.[6] In addition, 16 older firms have upgraded their governance to meet the Level 2 or Novo Mercado requirements. Only 4 of the newly public firms were cross-listed in the U.S. on level 2 or 3 (all level 2 listings on the NYSE). Another 23 of these firms have cross-listed in the U.S. on level 4 (Rule 144A) and 2 firms have cross-listed on level 1.

Table 3
Listing on foreign exchanges and different Bovespa levels

Firms which have common shares, non-voting preferred shares, or both cross-listed on a foreign stock exchange. Sample is 88 Brazilian private firms which responded to the 2005 Brazil CG Survey. Seven firms are listed both on the NYSE and on a non-U.S. exchange

Panel A. – Foreign cross-listing					
Type of shares		Common	Preferred	Both	Neither
US cross-listed firms (% of firms in sample)		1 (1%)	17 (18%)	2 (2%)	68 (78%)
NYSE		1	15	2	–
Level 3		0	5	2	–
Level 2		1	10	0	–
Level 1 (OTC)		0	1	0	–
Level 4 (Portal)		0	0	0	–
Non-U.S. listing		0	6	1	–
Panel B. – Bovespa Listing Level					
	Regular	Level 1	Level 2	Novo Mercado	Total
Bovespa level	66	17	3	2	88

Thus, a time series picture of cross-listing and Bovespa listing level choices is valuable. Table 4 provides this picture. It shows the number of Brazilian public firms – whether in our sample or not – which are cross-listed in the U.S., their cross-listing level, how many are cross-listed on foreign exchanges, and how many are listed on different Bovespa levels, from 2000 through the first half of 2007. The data on number of listed firms includes firms which have publicly listed debt but not equity, and thus is not directly comparable to the numbers in Table 1.

[6]The ANBID regulation is available at `www.anbid.com.br`

Table 4 also indicates the number of Brazilian firms which are cross-listed in the United States at the end of each year from 1995 on. The number of firms listed on the New York Stock Exchange or NASDAQ grows steadily through 2002 and then levels off. It is probably not a coincidence that the U.S. Sarbanes-Oxley Act (SOX), which applies to these firms, was adopted in 2002. Another factor in recent cross-listing decisions is likely Brazilian firms' ability to signal their corporate governance by listing on Novo Mercado or on Level 2. This could reduce the value of the additional signal provided by a level-2 or level-3 cross-listing.[7]

A large number of Brazilian firms are also cross-listed on level 1 (over the counter) or level 4 (Rule 144A). There is continued growth in the number of these cross-listings, principally on level 4. Level 4 and most level 1 cross-listed firms are not subject to SOX.

Table 4
Listing decisions over time: cross-listing and Bovespa level

Number of Brazilian public companies which are cross-listed outside Brazil (principally in the U.S.) and listed on the indicated Bovespa levels. Some firms with a regular Bovespa listing have public debt but not public equity. Data is provided by Bovespa, and is at year-end except for 2007

	Foreign cross-listing		Bovespa listing				
Year	NYSE or NASDAQ	U.S. (total cross-listings)	Regular	Level 1	Level 2	Novo Mercado	Total
1995	2	23	577	these levels were created in 2000			577
1996	3	35	589				589
1997	7	39	595				595
1998	17	53	599				599
1999	19	56	534				534
2000	22	60	494	0	0	0	494
2001	26	66	450	18	0	0	468
2002	33	72	407	24	3	2	436
2003	34	72	374	31	3	2	410
2004	35	76	343	33	7	7	390
2005	35	79	316	37	10	18	381
2006	32	82	300	36	14	44	394
2007	31	87	293	40	18	82	433
2008	31	94	279	43	18	99	439

5. Boards of Directors

5.1 Board size

The board of directors is a central aspect of every firm's corporate governance. Brazilian corporate law requires public companies to have a board of directors, with at least three members.[8] However, both CVM and IBGC recommend 5-9 member boards. Firms that list on Bovespa Level 2 or Novo Mercado must have at least 5 member boards.[9] In practice, most firms have relatively small boards. Table

[7] In Table 4, we show cross-listing in the U.S. but not in other countries. Relatively few Brazilian firms cross-list in other countries; of these, all but one (Bradespar, cross-listed in Madrid) also cross-list in the U.S.

[8] Law 6404/76, arts. 138 § 2, 140. Closely held companies do not need to have a board of directors.

[9] CVM Recommendations on Corporate Governance (2002), § 2.1; (Brazilian Institute for Corporate Governance (IBGC), 2003, § 2.10); Bovespa Level 2 Listing Rules (2006) § 5.3 and Bovespa Novo

5 shows the breakdown. Over two-thirds of the responding firms have boards with between 3 and 7 board members, with a mean of 6.8 and a median of 6 members. Only five firms (6%) have more than 11 directors.

Table 6 divides Brazilian private firms into quartiles based on market capitalization. Not surprisingly, the largest firms have larger boards. However, once we move below the first size quartile, board size is similar regardless of firm size. The 32 firms in the first quartile include all five firms with large boards (more than 11 members), but only one of the 14 firms with only 3 directors.

Table 5
Size of the board of directors

Board size and percentage for 88 Brazilian private firms which responded to the 2005 Brazil CG Survey. Minimum board size under Brazilian law is 3 directors

No. of directors	No. of firms	Percentage	Cumulative percentage
3	14	16%	16%
4	3	3%	19%
5	19	22%	41%
6	11	13%	53%
7	15	17%	70%
8	6	7%	77%
9	4	5%	82%
10	4	5%	86%
11	7	8%	94%
12-15	4	5%	96%
22	1	1%	100%
Mean (median)		6.8 (6)	

Table 6
Size of the board of directors

Board size and percentage for 88 Brazilian private firms which responded to the 2005 Brazil CG Survey. Minimum board size under Brazilian law is 3 directors. Quartiles are based on market capitalization as of Jan. 2005. Amounts in R$ millions

Quartile	Size range in reais R$	Firms in sample	Percentage	Mean	Median	Min.	Max.
1	1,061 to 86,739	32	36%	8.59	8	3	22
2	172 to 991	24	27%	5.96	6	3	10
3	20 to 158	21	24%	5.57	5	3	11
4	0 to 19	11	13%	5.64	5	3	11
	Total	88	100%	6.78	6	3	22

5.2 Board independence

Table 7 reports the breakdown of Brazilian boards between independent and non-independent directors. In many countries, firms must report this information publicly, or else report directors' backgrounds, from which their status can be inferred. Not so in Brazil, however. One can tell from annual reports which directors are also company officers. One can sometimes infer from last names which directors represent the controlling family, but not always because family members or representatives don't always have the same last names. We asked respondents to use the following definitions:

Mercado Listing Rules (2006) §4.3.

- **Non-independent directors**: are persons who are officers, former officers, or members or representatives of a controlling shareholder, shareholder group, or family (for example, a director who is an officer of another company controlled by the same controlling family, or the personal legal counsel to the controlling family, would be considered to be an inside director).

- **Independent directors**: are persons who are not officers or former officers and are independent of the controlling shareholder, controlling shareholder group, or controlling family.

Beyond requiring disclosure, a number of countries require public companies to have a minimum number of independent directors, or else recommend this through a comply or explain code of corporate governance, under which companies must either meet the governance recommendation or explain why not. The U.K. Combined Code of Corporate Governance (Financial Reporting Council, 2006) is the model for the comply or explain approach. Brazil has no legal requirements for board independence. Brazilian corporate law specifies that only one-third of board members may be company officers.[10] We follow common practice and refer to persons who are both directors and officers as executive directors, and other directors as *non-executive*. However, in many Brazilian companies, some or all of the non-executive directors represent the controlling family or group. The IBGC Code of Corporate Governance recommends that a majority of the board be independent, but this recommendation, our data show, is rarely followed. CVM recommends more vaguely that *as many board members as possible* be independent. A more realistic sense of how Brazilian firms are doing comes from Bovespa's listing rules, under which firms that want to list on Bovespa Level 2 or the Novo Mercado must have 20% independent directors. This means either one or two independent directors, depending on board size.[11]

Table 7 shows the numbers and fractions of independent directors for the 80 Brazilian private firms which provided this information in their survey responses (8 firms did not respond to these questions). By international standards, Brazilian firms have very few independent directors. Over a third of the responding firms with data on board composition (28/80) have no independent directors. Another 18% have only a single independent director. Only 10% have a majority of independent directors.

The tendency for Brazilian firms to have either no or few independent directors is not limited to smaller firms. Table 8 divides our sample into size quartiles based on market capitalization. Even the largest firms often have no independent directors. The tendency for the smallest quartile of firms to have more independent directors likely reflects sample selection bias among the limited number of small

[10] Law 6404/76, art. 143, § 1.

[11] CVM Recommendations on Corporate Governance (2002), § 2.1, IBGC Code of Best Practice of Corporate Governance (2003) , § 2.12 , Bovespa Level 2 Listing Rules (2006) § 5.3 and Bovespa Novo Mercado Listing Rules (2006) § 4.3.

firms which responded to the survey.

Table 7
Proportion of independent directors

Number and percentage of independent directors, for 80 Brazilian private firms which responded to the 2005 Brazil CG Survey and provided data on board composition. In computing proportion of independent directors, percentages are rounded up to next whole number

No. of independent directors	Number of firms	Cumulative percent	Proportion of independent directors	Number of firms	Cumulative percent
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%	61-70%	3	98%
			71% or more	1	98%
Mean		1.65	mean		0.24
Median		1.00	median		0.20
Total	80		total	80	

Table 8
Board independence by size quartile

Number and percentage of independent directors, by size quartile, for 80 Brazilian private firms which responded to the 2005 Brazil CG Survey and provided data on board composition. Quartiles are based on market capitalization as of Jan. 2005

Size quartile	Firms in sample	Number of independent directors				Percentage	
		Firms with zero indep. directors	Mean	Median	Max.	Mean	Median
1	30	8 (27%)	2.0	2	6	20	25
2	21	9 (43%)	1.4	1	6	17	21
3	18	9 (50%)	1.1	1	4	9	16
4	11	2 (18%)	2	2	7	40	38
Total	80	28 (35%)	1.65	1	7	24%	20%

At the time of our survey, 14 Brazilian firms were listed on Bovespa Level 2 or Novo Mercado; of these, six are included in our sample. These firms are subject to a Bovespa requirement of at least 20% independent directors.[12]

5.3 Representatives of controlling and minority shareholders

Brazilian firms typically issue both voting common shares and non-voting preferred shares. The preferred shares typically have similar economic rights to common shares. (We discuss these economic rights below.) Public Brazilian firms cannot issue U.S.-style preferred shares with fixed dividends. Thus, preferred shares are, in effect, similar to non-voting common shares. Until 2001, Brazilian corporate law allowed firms to issue up to 2/3 preferred shares. In 2001, the cap on preferred shares was reduced to 50%, but this lower limit applies only to firms that

[12] Bovespa Level 2 Listing Rules (2006) § 5.3.

go public after 2001. Firms with preferred shares cannot list on Novo Mercado.[13] Seventy-four firms in our sample (84%) have issued preferred shares.

Almost all Brazilian firms have a controlling shareholder or group, which owns a majority of the common shares. This shareholder or group chooses a majority of the board members. However, under legal rules described below, preferred shareholders or minority common shareholders can often elect their own representative(s) to the board. Table 9 asks whether any independent directors represent preferred shareholders, minority common shareholders, or both. The table is limited to the 52 firms with one or more independent directors. Below, we refer to preferred shareholders and minority common shareholders together as *minority shareholders*.

Table 9
Whom do independent directors represent?

Number of directors who represent preferred shareholders or minority common shareholders, for 52 Brazilian private firms which responded to the 2005 Brazil CG Survey, provided data on board composition, and have at least one independent director. Of these firms, 48 have issued preferred shares

	Director represents					
Number of directors in category	Preferred shareholders	Percent	Minority common shareholders	Percent	Either preferred or minority common shareholders	Percent
none	28	58%	30	58%	19	37%
1	17	35%	14	27%	16	31%
2	2	4%	7	14%	13	25%
3	1	2%	1	2%	3	6%
4	0	0	0	0	1	2%
one or more	20	42%	22	42%	33	63%

Among firms with at least one independent director, 20 firms (42% of firms with preferred shares) have a representative of the preferred shareholders in the board; 22 firms (42%) have a representative of the minority common shareholders; and 33 firms (63%) have a representative of one or both groups of minority shareholders. Including firms with no independent directors, 33/80 (41%) of the responding firms have one or more independent directors who represent minority shareholders.

Under Brazilian law, there are two basic ways that minority shareholders can be represented on a company's board of directors. First, common shareholders holding at least 10% of the common shares can demand cumulative voting. However, cumulative voting is not often employed in practice. Of the 86 firms who responded to this question, 10 (12%) reported that cumulative voting had been used at least once in the last five years. Cumulative voting was used once at four firms, twice at four firms, three times at one firm, and in all five years at one firm.

[13] Law 6404/76, art. 15, § 2 (2/3 limit), amended by Law No. 10.303 of 2001 (50% limit). For the grandfathering provision, see Law No. 10.303 of 2001, art. 8; Bovespa Novo Mercado Listing Rules (2006), § 3.1(vi).

Second, preferred shareholders, minority common shareholders, or both together, can vote separately to elect one representative by majority vote of all shares in the indicated group, as follows:[14]

- By minority common shareholders, if minority common shares are at least 15% of total common shares;
- By preferred shareholders, if preferred shares are at least 10% of total shares;[15]
- By all minority shareholders together, if they hold at least 10% of total shares and neither the 15% threshold for common shares nor the 10% threshold for preferred shares is met.

There are no procedures for minority shareholders to inform other shareholders about candidates before a meeting, so as a practical matter these rights are available primarily to large minority shareholders who can show up at the shareholder meeting, nominate a director, and cast a sufficient number of votes to elect this person. In addition to these formal rights, the controlling shareholder can include a representative of the minority on the main list of candidates.

We turn next to a more detailed look at the *non*-independent directors. The first two columns of Table 10 show the number of non-independent directors at each firm. A large majority of firms has 3 or more non-independent directors. The remaining columns of Table 10 show the *number* of non-independent directors who are officers or former officers, the number who are not officers but represent the controlling shareholder, and the number who also sit on the boards of one or more related firms. These related firms could be either public or private. Perhaps due in part to the legal requirement that officers cannot be more than 1/3 of the overall board, most firms have only one or two officers or former officers on their board; some have none. Altogether, only 23 of the 88 respondents (26%) have three or more directors in this category.

If most directors are not independent, as we have seen, and only a minority can be officers, it makes sense that a fair number will be non-officer representatives of the controlling family or group. Table 10 confirms this. The board of 67 of the 88 respondents (76%) include at least one such person; most firms (66%) have two or more such directors, and the mean firm has three such persons on its board. It is also reasonably common for firms to have overlapping boards – 46 of the 86 respondents on this question (53%) indicated that at least one director was also on the board of a related firm.

[14]Law 6404/76 art. 141, § 4-5, as amended by Law 10.303/2001. These rights are available only to shareholders who have held shares continuously for the 3 months preceding the meeting.

[15]Through 2006, the controlling shareholder could require the preferred shareholders to choose their representative from a list of three persons proposed by the controlling shareholder. Law 10.303/2001, art. 8, § 4.

Table 10
Non-independent directors

Number of non-independent directors who are (i) officers; (ii) representatives of the controlling shareholder or group, or (iii) also on the boards of one or more related firms, for 88 Brazilian private firms which responded to the 2005 Brazil CG Survey (80 responses for board composition; 86 responses for question about related firms). Percentage is of firms which answered each question

No. of directors	All non independent directors	%	Officers or former officers	%	Represents controller (but not officer)	%	On the board of related firm(s)	%
0	0	0	14	16	21	24	59	67
1	2	2.5	35	40	9	10	9	10
2	4	5	16	18	17	19	4	4.5
3	25	31	12	14	11	13	0	0
4	9	11	7	8	7	8	2	2
5	10	12.5	3	3	7	8	3	3
6 or more	30	37.5	1	1	16	7	11	12.5
Mean	5.3		1.7		3.1		1.55	
Median	4		1		2		1	

5.4 Are the CEO and chairman the same person?

A common governance recommendation is that the CEO and Chairman positions should be split, to prevent the CEO from having too much power over the firm. This concern is less important when the CEO is a hired manager, facing oversight from a controlling family or group. Separation may also not be important if the CEO is a member of the controlling family or group because the controllers, not the board, will decide who runs the firm. Nonetheless, CVM recommends splitting these two roles.[16]

Most Brazilian firms have different persons as CEO and Chairman; 62 of the 88 respondents (71%) separate these two roles. A separate question is whether some firms have a nonexecutive chairman who does not represent the controlling family or group. This pattern is common in the U.K. We did not ask about this, but the common Brazilian pattern is for the chairman to represent the controller.

5.5 Director characteristics

There are no legal requirements that directors have particular expertise. CVM recommends that at least two directors should possess *experience in finance and primary focus on accounting practices*. IBGC recommends a diversified board, its list of criteria includes *financial knowledge and accounting knowledge*. IBGC also recommends that each firm have an audit committee with at least three members, who should be *familiar with basic financial and accounting matters*.[17] In addition, many cross-listed firms are subject to the Sarbanes-Oxley Act, which applies to all NYSE and NASDAQ-cross-listed firms, and contains requirements for audit committees, minimum number of independent directors, and other matters.

[16] CVM Recommendations on Corporate Governance (2002), § 2.4.

[17] CVM Recommendations on Corporate Governance (2002), § 2.1; IBGC Code of Best Practice of Corporate Governance (2003), §§ 2.9.2, 2.17.

Table 11 summarizes which firms have directors with particular characteristics and experience. It is quite common for firms to have a director with financial or accounting expertise. Lawyers are also common board members. About one-fourth of private firms have a politician or former government employee on their boards. Scholars are apparently in less demand; only 8 firms have one on their board.

Table 11
Director expertise and background

Characteristics and background of directors of 88 Brazilian private firms which responded to the 2005 Brazil CG Survey and provided data on board composition. Number of responses varied from 85-88. Percentage is of firms which answered each question

One or more directors that are	Yes	% yes	If yes:	
			Mean	Median
Financial sector specialist	64	74%	3.2	2
Accounting specialist	50	57%	2.4	1
Lawyers	46	52%	1.5	1
Female	29	33%	1.5	1
Politician or former government employee	26	31%	2.4	2
Foreign	22	25%	2.6	2
Employee representative	11	12%	1.2	1
Scholar	8	10%	1.3	1

5.6 Director terms in office

Table 12 provides information on board terms, and whether they are staggered, with a fraction of the board elected each year. Brazilian law allows directors to serve for terms of up to three years, but makes them subject to removal by shareholders at any time. It is silent on whether these terms can be staggered.[18] Since most Brazilian firms have a controlling shareholder or shareholder group, and in any case shareholders can remove directors at any time, a staggered board is not important as a takeover defense. A staggered board can make it more difficult for minority shareholders to elect representatives using cumulative voting, but Brazilian law provides other ways for minority shareholders to be represented on public company boards. Thus, in contrast to the United States (Bebchuk et alii, 2002), a staggered board is likely not an important aspect of governance for Brazilian firms. Only 2 respondents have staggered board terms.

Multiyear terms are common: Almost half (42/88; 48%) use the maximum 3-year term permitted by the law; another 15 firms (17%) have two year terms. CVM and IBGC recommend that all board members should serve concurrent one-year terms of office.[19] Bovespa requires directors of companies listed on Level 2 or Novo Mercado to have non-staggered board terms of either one or two years.[20] Bovespa initially required annual terms, but changed to instead allow two-year

[18] Law 6404/76, art. 140.

[19] CVM Recommendations on Corporate Governance (2002), § 2.1; IBGC Code of Best Practice of Corporate Governance (2003), § 2.18.

[20] Bovespa Novo Mercado Listing Rules (2006) § 4.4; Bovespa Level 2 Listing Rules (2006) § 5.4.

terms – as we understand, at the request of institutional investors who preferred longer terms for their own nominees.

Table 12
Board terms: staggered and non-staggered

Number of years of directors' terms and whether they are staggered, for 88 Brazilian private firms which responded to the 2005 Brazil CG Survey

Number of years	Staggered		Non-Staggered		Total
	Number of firms	Percent	Number of firms	Percent	Number of firms
1	–	–	31	35%	31
2	0	0	15	17%	15
3	2	2%	40	46%	42
Total	2	2%	86	98%	88

6. Board and Committee Procedures

We turn next from the substance of who sits on the board of directors, to the procedures the company follows, in holding board and committee meetings.

6.1 Board meetings and minutes

Brazilian law does not require a minimum number of board meetings. CVM recommends that the board should establish a minimum meeting frequency, but contains no numerical recommendation; IBGC does not propose a minimum number of meetings, but does suggest a maximum of one meeting per month, "to avoid undue interference" in the operation of the business.[21]

Table 13
Meetings of the board of directors

Number of total, physical, and telephonic board meetings in 2004 for 87 Brazilian private firms which responded to the 2005 Brazil CG Survey and provided this information

Number of meetings	Total meetings	%	Physical meetings	%	Telephone meetings	%
0	0	0	2	2	75	87
0 - 3	3	3	5	6	4	5
4 - 6	24	28	25	29	4	5
7 - 9	16	18	15	17	1	1
10 - 12	21	24	18	21	1	1
13 - 18	8	9	12	14	0	0
19 or more	15	17	10	12	1	1

[21] CVM Recommendations on Corporate Governance (2002), § 2.2; IBGC Code of Best Practice of Corporate Governance (2003), § 2.30.

Table 13 provides information on the number and type of board meetings held during the previous year (2004). Most Brazilian firms hold at least 4 meetings per year. We asked separately about physical and telephonic meetings, on the grounds that while a telephonic meeting can be useful for handling small or emergency items, only a physical meeting is likely to generate a real discussion, or useful advice to the company's management. If we treat four physical meetings per year as a minimum for an effective board, only seven firms (8%) failed this standard. However, two firms did not have a single physical meeting for the entire year. One wonders what these firms' directors thought their job consisted of.

Two-thirds of the responding firms (58/87) had between four and 12 meetings per year, which is a normal number by international standards. However, some reported a large number of meetings – indeed ten firms reported 19 or more meetings in the last year. It is possible that these meetings are often short and involve mostly insiders. This pattern could make sense for smaller companies, especially those with no independent directors. These firms might have a weekly or biweekly management meeting, and call it a board meeting. Telephone meetings are uncommon. Only 11 firms (13%) used them at all, although a few made frequent use of this meeting procedure.

A standard corporate governance recommendation is that companies prepare written minutes of board meetings, which indicate who attended the meeting, the issues voted on, and the voting outcomes. Brazilian law requires firms to keep minutes of board meetings, but does not specify the content of the minutes.[22] IBGC recommends that listed companies should forward their minutes to CVM or Bovespa, and indicate any dissenting votes.[23] A fair number of Brazilian firms are lax in this regard. Five firms (6%) did not keep written minutes, despite the legal requirement. Only about half (41 of 83 respondents on this question) recorded directors' votes.

6.2 Board processes

Table 14 summarizes Brazilian practice for selected board processes. These processes are not required by Brazilian corporate law, but many are recommended by CVM and IBGC. On the whole, Brazilian boards adopt a relatively small number of formal processes. This is consistent with many boards being both small and dominated by the controller.

Both CVM and IBGC recommend that the board of directors annually evaluate the CEO's performance.[24] Only about a third of responding firms (28/88) do so. A slightly larger number (34/88; 38%) evaluate other officers. IBGC recommends that the board have a succession plan in place for the CEO and all other key persons

[22]Law 6404/76, arts. 100 § VI, 130 § 1. Article 130 states that the minutes "may" include a summary of the matters discussed, and any dissents.

[23]IBGC Code of Best Practice of Corporate Governance (2003), § 1.5.4.

[24]CVM Recommendations on Corporate Governance (2002), § 2.1; IBGC Code of Best Practice of Corporate Governance (2003), § 2.26.

in the organization.[25] Only 15 firms (21%) have such a plan. For some firms, however, the controlling family may have an informal succession plan within the family – we did not ask about this.

Both CVM and IBGC recommend that the board adopt bylaws to regulate its own duties and meetings.[26] A bit over half of the responding firms (48/88) have done so. Most companies (91%) provide materials to board members in advance of board meetings.[27] However, only a few (7/52; 14%) formally provide for independent directors to retain their own advisors, at the company's expense.[28]

IBGC recommends that firms should have a code of conduct, approved by the Board of Directors, which regulate the relations between the board, shareholders, employees, suppliers, and other stakeholders.[29] About half of the responding firms have a code of conduct; we did not ask about what it covers.

Table 14
Board processes

Number of firms which adopted the indicated board processes, for 88 Brazilian private firms which responded to the 2005 Brazil CG Survey. Questions relating to independent directors apply only to 52 firms with one or more independent directors. The survey asked for *yes* answers, but not *no* answers, so we cannot distinguish *no* from *missing*

Process	Yes	% yes	No/ missing	Total
Affecting all directors				
Regular system for evaluating the CEO's performance	28	32%	60	88
Succession plan for the CEO	15	21%	73	88
Regular system for evaluating other officers	34	39%	54	88
Specific bylaw to govern the activity of the board of directors	48	55%	40	88
Company code of conduct or ethics	45	51%	43	88
Board members receive materials in advance of board meetings	80	91%	8	88
Independent directors can obtain outside advice at company's expense	7	14%	45	52
Affecting only independent directors				
Regular system for evaluating independent directors	6	12%	46	52
Retirement age for independent directors	3	6%	49	52
Annual meeting exclusively to independent directors	1	2%	51	52
None of the above	0		88	88

IBGC recommends that the Chairman should annually review the performance of other directors.[30] We did not ask about this, but did ask whether the board regularly reviews the performance of independent directors. Only 6 of the 52 firms with one or more independent directors did so. IBGC recommends that firms establish a maximum length of service on the board.[31] We did not specifically ask about this, but did ask whether firms have a retirement age for independent directors; only 3 firms have such a policy. IBGC recommends that independent

[25]IBGC Code of Best Practice of Corporate Governance (2003), §2.27.

[26]CVM Recommendations on Corporate Governance (2002) § 2.2; IBGC Code of Best Practice of Corporate Governance (2003), § 2.5.

[27]CVM so recommends. CVM Recommendations on Corporate Governance (2002) § 2.2.

[28]CVM again so recommends. CVM Recommendations on Corporate Governance (2002) § 2.2.

[29]IBGC Code of Best Practice of Corporate Governance (2003), §3.7.

[30]IBGC Code of Best Practice of Corporate Governance (2003), § 2.15.

[31]IBGC Code of Best Practice of Corporate Governance (2003), § 2.19.

directors should meet regularly, without officers or other directors present, in part so they can assess management's performance.[32] Only one company has adopted this practice. To be sure, however, such a practice makes sense only if a company has a reasonable number of independent directors, say three or more. Only 22 firms have this many independent directors.

6.3 Specific board actions

Brazilian boards are not strong on formal processes, as we have just seen. But how do they behave? We asked about a number of important board actions within the last five years. At 20 firms (23%), the board had "replaced" the CEO (Portuguese: substituiu). This could include both dismissal for poor performance and normal replacement when the CEO retires or becomes ill. Similarly, the board of 25% of the firms had replaced, or asked the CEO to replace, one or more officers.

For firms with independent directors, we asked whether the board had asked an independent director to resign, or had not renominated this person, during the last five years. Four firms out of 52 with independent directors (8%) had done so. None of the respondents stated that an independent director had resigned because of a dispute over policy during this period.

Table 15
Actions of the board

Number of firms which adopted the indicated board processes, for 88 Brazilian private firms which responded to the 2005 Brazil CG Survey. Questions relating to independent directors apply only to 52 firms with one or more independent directors. The survey does not let us distinguish *no* answers from *missing* responses

Within the last 5 years, has	Yes	% Yes	No/missing	Total
The board replaced the CEO	20	23%	68	88
The board replaced (or asked the CEO to replace) one or more other officers	22	25%	66	88
The board asked an independent director to resign, or did not propose reelection of an independent director	4	8%	48	52
An independent director resigned because of a dispute over policy	0	0%	52	52

6.4 Board committees

Brazilian corporate law is silent on committees of the board of directors, and forbids the board from delegating its authority *to another body created by law or (the company's) bylaws*.[33] It is interpreted to permit their creation, but the committee's authority to take action remains unclear. Presumably, a committee can take actions which the board is not required to take in the first place, much as management can.

[32] IBGC Code of Best Practice of Corporate Governance (2003), § 2.13.
[33] Law 6404/76, art. 139.

CVM and IBGC recommend rather vaguely that firms should have "specialized" board committees. They recommend an audit committee, but not other specific committees.[34] Bovespa has no committee requirements. Only 25 respondents (28%) have standing committees of the board. Of these firms, 20 (80% of the firms with committees) prepare minutes of committee meetings, and of these 20 firms, half (10 firms) record directors' votes on agenda items.

Table 16
Board committees

Number of firms which adopted the indicated board processes, for 88 Brazilian private firms which responded to the 2005 Brazil CG Survey. Question on existence of committee minutes (content of minutes) apply only to 25 firms with one or more standing committees (20 firms which prepare committee minutes)

	Yes	% yes	No	Total
Does the board have standing committees?	25	28%	63	88
If the board has standing committees, are minutes prepared for meetings of the committees?	20	80.0	5	25
If minutes are prepared for committee meetings, are directors' votes recorded in the minutes?	10	50.0	10	20

7. Audit Committee, Fiscal Board, and Independent Auditor

Brazilian law does not expressly provide for audit committees or other committees of the board of directors. It does provide for a related body, known as a fiscal board, which may partly substitute for the audit committee. We next discuss audit committees, fiscal boards, and independent auditors.

7.1 Audit Committee

Audit committees are a familiar part of the overall governance system in many countries, but not yet in Brazil. CVM and IBGC both recommend that firms create an audit committee of the board of directors.[35] Bovespa does not require an audit committee, for any listing level. Only 15 respondents (17%) of the responding firms have an audit committee. All 15 of these committees include at least one person with accounting expertise; at 14 firms the committee meets with the outside auditor at least once per year; and 12 firms have bylaws to govern the committee's operations.

[34]CVM Recommendations on Corporate Governance (2002) §§ 2.2, 4.3; IBGC Code of Best Practice of Corporate Governance (2003), §§ 2.8-2.9.

[35]CVM Recommendations on Corporate Governance (2002) § 4.3; IBGC Code of Best Practice of Corporate Governance (2003) § 2.9.

However, even when an audit committee exists, it is often staffed entirely by inside directors. Only seven of the 15 firms with an audit committee include even a single independent director on the committee. This rather defeats the central value of the committee, as used in other countries, which is to provide independent oversight of the firm's financial statements and its relations with its outside auditor. In four of these firms, minority shareholders can elect one or more members of the committee.[36] But only two firms have a committee staffed solely by independent directors.[37] Of the five firms with both independent and non-independent members of the audit committee, three provide that the independent members meet separately with the outside auditors at least once per year.

One customary task for the audit committee is overseeing the company's independent auditors. Under Brazilian law, one board duty is to select and discharge the firm's independent auditors. This duty cannot be delegated. Thus, while the audit committee can recommend hiring or dismissing the auditing firm, doing so requires full board action.[38]

Table 17
Audit committee of the board of directors

Number of firms which have audit committees, and related procedures, for 88 Brazilian private firms which responded to the 2005 Brazil CG Survey. Questions on procedures apply only to 15 firms with an audit committee. Last question applies only to five firms which are known to have both independent and non-independent members on the audit committee

	Yes	% yes	No	Missing/do not apply	Total
The firm has an audit committee	15	17	73	0	88
For firms with an audit committee:					
The committee includes a member with expertise in accounting	15	100	0	0	15
The committee meets with the external auditor at least once per year	14	93	1	0	15
There is a bylaw to govern the committee	12	80	3	0	15
Audit committee independence:					
The committee includes at least one independent director	7	47	6	2	15
The committee consists solely of independent directors	2	15	11	2	–
Minority shareholders can elect one or more members of the committee	4	27	11	0	15
If the committee includes both inside and independent directors, the independent members meet separately with the external auditor at least once per year	3	60	2	0	5

[36]CVM recommends that at least one member represent minority shareholders. CVM Recommendations on Corporate Governance (2002) § 4.3.

[37]IBGC, recommends that all members of the audit committee should be independent. IBGC Code of Best Practice of Corporate Governance (2003), § 2.9.1. CVM recommends that the audit committee should not include company officers, but does not recommend that all members be independent. CVM Recommendations on Corporate Governance (2002) § 4.3. Our survey did not ask whether officers served on the audit committee.

[38]Law 6404/76, arts. 139 (no board power to delegate power to committees); 142(IX) (board chooses and replaces auditors).

7.2 Fiscal board

Brazilian corporate law is silent on audit committees, but expressly contemplates the creation of a separate body, not part of the board of directors, known as a fiscal board, charged with examining the company's financial statements and offering an opinion on them. The fiscal board can engage experts (presumably a second accounting firm), at the company's expense. Each company must provide procedures in its bylaws for the fiscal board to operate; the law specifies that it must have between 3 and 5 members.[39]

Actual creation of the board is optional – a company can have a permanent fiscal board, or merely provide for the existence from time to time of a temporary board. A temporary fiscal board must be created on demand by minority shareholders – the percentage thresholds to make this demand are 10% of common shares or 5% of preferred shares for small firms, but only 2% of common or 1% of common shares for large firms. The temporary board's authority expires at the next annual shareholder meeting; but the shareholder demand for the board can be renewed at that meeting.[40]

Table 18 describes firms which have a permanent fiscal board. About 40% of firms have such a board (34/88). If a fiscal board exists, it is required by law to keep minutes; all 34 firms reported doing so.[41] However, only 22 of the firms with permanent fiscal boards (65%) record member votes in the minutes. And 5 of the firms with a permanent fiscal board report not having a bylaw to govern the functioning of the fiscal board, even though this is required by law. Only a bit more than half of the firms (18/34: 53%) had fiscal boards which includes a member with accounting expertise.

Table 18
Fiscal board

Number of firms which have a permanent fiscal board, and related procedures, for 88 Brazilian private firms which responded to the 2005 Brazil CG Survey. Questions on procedures apply only to 34 firms with a permanent fiscal board

	Yes	% yes	No	Total
Does the company have a permanent fiscal board?	34	39%	54	88
For firms with a permanent fiscal board				
Minutes are prepared for meetings of the board?	34	100%	0	34
There is a bylaw to govern the fiscal board?	29	85%	5	34
When minutes are prepared, directors' votes are recorded in the minutes?	22	65%	12	34
The board includes a member with expertise in accounting?	18	53%	16	34

[39] Law 6404/76, art. 161 §1.
[40] Law 6404/76, arts. 161, 163.
[41] Law 6404/76, art. 100(VI).

Table 19 provides details on the size of the permanent fiscal board, and how often it meets with the external auditor. Three firms have a board of at least six members, despite the statutory requirement of a 3-5 member board. To be sure, the policy reasons for capping fiscal board size at five members are not apparent. Most boards meet with the external auditor either quarterly (16 firms) or annually (11 firms); but at three firms the fiscal board does not meet with the external auditor at all.

We turn next to minority shareholder representation on the fiscal board. One might think that the fiscal board, much like the audit committee, should be a watchdog on behalf of noncontrolling shareholders. If so, including representatives of controlling shareholders on the board makes little sense. This is not, however, how Brazilian corporate law operates. The law instead gives the holders of preferred shares the right to elect one member of the fiscal board, and gives minority common shareholders holding at least 10% of the common shares a similar right. Other common shareholders can then elect the remaining members, in a number equal to those elected by preferred shareholders and minority common shareholders plus one.[42] This ensures that the controlling shareholders can control the fiscal board.

Table 19
Permanent fiscal board: size and meetings with auditors

Size of fiscal board and number of meetings with external auditor, for 34 Brazilian private firms which have a permanent fiscal board and responded to the 2005 Brazil CG Survey

Number of members	No. of firms	No. of meetings (per year)	Number of meetings between fiscal board and external auditor
3	17 (50%)	0	3 (9%)
4	4 (12%)	1	11 (32%)
5	10 (29%)	2 or 3	3 (9%)
6 or more	3 (9%)	4	16 (47%)
–	–	5	1 (3%)

CVM has a complex recommendation on the composition of the fiscal board – it recommends that minority shareholders should have the right to elect one (two) member(s) out of a three or five member board if the control group elects one (two) members. The controlling group should then cede its rights to elect the last member, who should instead be elected by a shareholder vote, with common and preferred shares each carrying one vote. IBGC has a similar recommendation.[43] We did not ask whether any firms adopt this complex structure, but two firms reported having three representatives of minority shareholders, perhaps because they followed this approach.

[42] Law 6404/76 Art. 161, § 4 b.

[43] CVM Recommendations on Corporate Governance (2002) § 4.2; IBGC Code of Best Practice of Corporate Governance (2003) § 5.2.

Table 20 provides information on the minority shareholder representatives on permanent fiscal board. Only 3 firms (9%) have no minority representatives. But another 19 firms (56%) have only one minority shareholder representative on the fiscal board, and only three firms have three or more minority representatives (who therefore comprise a majority of the board).

Table 20
Minority representation on permanent fiscal board

Minority shareholder representatives on fiscal board for 34 Brazilian private firms which have a permanent fiscal board and responded to the 2005 Brazil CG Survey

–		Represent minority common shares			
		0	1	2	Total
Represents preferred shares	0	3	2	0	5
	1	17	7	1	25
	2	2	1	0	3
	6	1	0	0	1
	Total	23	10	1	34

One might think that the audit committee and the fiscal board are likely to be substitutes, so that even firms which had one or the other might not have both. As Table 21 shows, this was partly true, but only partly. Of the 15 firms with audit committees, 7 had a permanent fiscal board as well; 8 did not. Of the 73 firms without an audit committee, 27 (31%) had a permanent fiscal board, but 46 firms (52%) had neither.

Table 21
Crosstabulation: audit committee and permanent fiscal board

Crosstabulation for firms with audit committee, permanent fiscal board, both, or neither, for 88 Brazilian private firms which responded to the 2005 Brazil CG Survey

–	Permanent fiscal board		No permanent fiscal board		Total
–	No. of firms	Percent	No. of firms	Percent	
Audit committee	7	8%	8	9%	15
No audit committee	27	31%	46	52%	73
Total	34	39%	54	61%	88

Next, what about the firms without a permanent fiscal board? How often did shareholders demand that the firm create a non-permanent board? Table 22 provides this information. At 24 of the 52 firms which responded to this question, the nominally non-permanent board was, in practice, permanent or nearly so, having been convened in four or five of the last five years.[44] If we treat these firms as having a permanent or near-permanent fiscal board, two thirds of the responding firms (58/88) have such a fiscal board. Of the remaining 30 firms, two have an audit committee, leaving 28 firms (32%) with neither an audit committee nor a permanent or near permanent fiscal board. At all but 12 firms, a fiscal board has been convened at least once during the last five years (3 of these 12 firms have

[44]One firm indicated that the non-permanent board had been convened 20 times – we interpreted this to mean quarterly meetings each year in each of the last five years.

audit committees). Thus, the fiscal board is an important institution in Brazil. Further research is needed to understand its strengths and weaknesses, compared to an audit committee, and whether it makes sense for a firm to have both a fiscal board and an audit committee.

Table 22
Non-permanent fiscal board: how often used

Number of times non-permanent fiscal board was convened during last five years, for 52 Brazilian private firms which do not have a permanent fiscal board and responded to this question on the 2005 Brazil CG Survey

Number of times convened	Number of firms	Percentage
0	12	23
1	7	14
2	4	8
3	5	10
4	10	19
5	14	27

7.3 External auditor

Brazilian law requires public Brazilian firms to have their financial statements audited by an independent auditor.[45] CVM rules require public companies to rotate their external auditor every five years. Once an auditor has been rotated away from a particular company, the company cannot rehire this auditor for at least three years.[46] Only two firms reported having the same auditor for more than five years.

We asked firms whether they had replaced their external auditor within the last five years. In theory, all firms should have done so, but in practice, only 49 firms answered yes. Of these, 31 cited legal reasons (presumably the rotation requirement). Of the others, six responded that their auditor had gone out of business, six were unhappy with the auditor's fees, and six cited other reasons. Four firms indicated their reasons – two wanted to use the same auditor as the controlling firm (2 firms), one moved to an internationally known auditor (1 firm), and one cited *unspecified problems*. No firm reported changing auditors after a dispute over accounting policy. However, such a dispute could still have been part or most of the reason for replacement in some cases.

We asked whether the auditor also performs non-audit services. Providing these services could create a conflict of interest for the auditor, since if it loses the firm as an audit client, it will likely lose non-audit contracts as well. CVM recommends that public companies should not hire their auditors for other services that may raise conflicts of interests, and should limit non-audit fees as a percentage of total fees paid to the auditor. IBGC recommends more mildly that the audit committee (or the board for firms without an audit committee) "should be aware of" all services provided by the external auditor, should disclose to shareholders the auditing and other fees paid to the external auditor, and should be sensitive to

[45] Law 6404/76 Art. 177, § 3.
[46] Instruction CVM No. 308 (1999), art. 31.

the potential for conflicts.[47] Only 16 firms (18%) obtain non-audit services from their auditor. In part, this may be because mandatory rotation prevents the long-term relationships which are likely to lead to firms using their auditor for non-audit services. Of these firms, only five reported that non-audit fees represented 10% or more of the auditor's total fees.

Table 23
Relation with external auditor

Information about external auditor for 88 Brazilian private firms which responded to the 2005 Brazil CG Survey. Responses on replacement of auditor exclude replacement for legal reasons

	Yes	Yes %
Within the last 5 years		
Company employs external auditor for non-audit services	16	18%
Company replaced the external auditor	18	20%
Reason for replacing auditor		
Auditor went out of business	6	7%
Fees charged	6	7%
Disagreement over accounting policy	0	0%
Other reasons	6	7%

8. Shareholder Meetings and Shareholder Rights

We discuss in Section 5 above the rights of minority shareholders to elect representatives to the board of directors. We discuss in this section the rights of minority shareholders in connection with shareholder meetings, sales of control, share offerings, and other matters.

8.1 Shareholder meetings

Table 24 reports responses to several questions related to the holding of shareholder meetings. Brazilian law requires public companies to provide at least 15 days notice of a shareholder meeting, including the agenda for the meeting. However, both CVM and IBGC recommend 30 days notice, and CVM recommends 40 days for firms whose shares are cross-listed in other markets.[48] Only seven firms (8%) reported that they provide at least 30 days notice of shareholder meetings (2 of these are cross-listed on a foreign exchange).

Brazilian law requires the notice of a shareholder meeting to include the agenda for the meeting. IBGC recommends that the agenda and accompanying documentation "should be as detailed as possible." CVM recommends that the notice should contain a "precise description" of the agenda items. [49] We asked firms whether the names of director candidates are included in the notice of a shareholder meeting. Only 12 firms (14%) answered that they do so.

[47] CVM Recommendations on Corporate Governance (2002) § 4.4; IBGC Code of Best Practice of Corporate Governance (2003) § 4.6.

[48] Law 6404/76, art. 124, § 1, item II; CVM Recommendations on Corporate Governance (2002) § 1.2; IBGC Code of Best Practice of Corporate Governance (2003) § 1.5.2.

[49] Law 6404/76, art. 124; CVM Recommendations on Corporate Governance (2002) § 1.1; IBGC Code of Best Practice of Corporate Governance (2003) § 1.5.4.

Table 24
Shareholder meetings

Sample is 86 Brazilian private firms which responded to the 2005 Brazil CG Survey and provided information on shareholder meetings. Number of responses varies from 84 to 86

Provision	Yes	% yes
Company provides at least 30 days notice of annual meeting	7	8%
Company discloses director candidate names in advance of annual meeting	12	14%
Company considers conflicts with annual meetings of others companies in the same industry when it schedules its annual meeting	18	21%
Company discloses an annual agenda of corporate events	35	41%

CVM recommends that meetings should be held at dates and times that "do not impair shareholder attendance"; IBGC recommends affirmatively choosing the venue, date and time to encourage attendance.[50] We asked whether, in scheduling annual meetings, companies consider possible conflicts with the annual meetings of other companies in the same industry. Only eighteen firms (21%) reported doing so.

Firms listed on Bovespa Level 1 and higher must provide investors, by the end of January of each year, with an agenda of important corporate events for the year, including the date of the annual shareholder meeting.[51] A fair number of firms (35 firms; 41%) do this.

8.2 Rights of preferred shareholders

Table 25 reports survey results for questions relating to the rights of preferred shareholders. Most Brazilian companies issued preferred (non-voting) shares – 74 of the 86 firms which responded to the questions on shareholder rights have issued preferred shares. Brazilian law requires that public companies which issue preferred shares give these shares one of three types of advantages, relative to common shares. These advantages, and the number of firms which provide them, are:[52]

- dividends 10% higher than the dividends on common shares (39 firms, or 53%);
- dividends of at least 25% of net income (25 firms, or 34%);
- takeout rights on a sale of control, which provide at least 80% of the per-share price paid for the control block (17 firms, or 23%).

[50]CVM Recommendations on Corporate Governance (2002) § 1.1; IBGC Code of Best Practice of Corporate Governance (2003) § 1.5.3.

[51]Bovespa Level 1 Listing Rules (2006), § 4.5.

[52]Law 6404/76, art. 17. Under Law 6404/76, art. 111, preferred shares acquire voting rights if no dividends are paid for a period specified in the bylaws, which cannot exceed 3 years.

IBGC recommends that firms provide takeout rights for both preferred shares and minority common shares at 100% of the per share price paid for control.[53] Bovespa requires takeout rights for preferred shares for Level 2 firms, of at least 80% of the per share price paid for control.[54] Of the 17 firms which provide takeout rights to preferred shareholders, 12 do so at 80% of the per-share price paid for control; the other 5 firms do so at 100% of this price.

We also asked whether the company provides voting rights to preferred shareholders on particular matters. Bovespa's Level 2 rules require preferred shareholders to have voting rights, together with the common shareholders, for:[55]

(a) transformation, merger, consolidation or spin-off of the company;

(b) approval of conflict-of-interest transactions with a controlling shareholder (assuming that the transaction is one which requires shareholder approval under law or the company's bylaws);

(c) valuation of non-monetary assets contributed in exchange for shares; and

(d) changes to the bylaws which affect the rights of preferred shareholders.

CVM recommends that preferred shareholders have voting rights in the first three instances.[56]

Table 25
Selected rights of preferred shareholders

Sample is 74 Brazilian private firms which responded to the 2005 Brazil CG Survey and have preferred shares

	Yes	% yes
Special rights (one of these is required by law)	–	–
10% higher dividends than on common shares	39	53%
Dividends of at least 25% of net income	25	34%
Takeout rights, at price of at least 80% of the price paid for the control block	17	23%
Voting rights		
Mergers, transformations and similar transactions	9	12%
Transactions with controlling shareholder involving conflict of interest, which require shareholder approval	6	8%
Evaluation of non-monetary assets given in exchange for stocks	2	3%
Approving the external company which determines economic value during a freezeout	3	4%
Other rights		
Freezeout must be at price based on economic value of the company	8	11%
Company has a class of preferred shares that gives special voting rights to its holders when compared to other preferred shares	3	4%

[53]IBGC Code of Best Practice of Corporate Governance (2003) § 1.6.

[54]Bovespa Level 2 Listing Rules (2006), § 8.13. Three of the 17 firms which provide takeout rights to preferred shareholders are listed on Bovespa Level 2.

[55]Bovespa Level 2 Listing Rules (2006), §§ 4.1(V), 10.1.1.

[56]CVM Recommendations on Corporate Governance (2002) § 3.1. CVM also recommends that preferred shareholders have voting for alteration of the company's activity and reduction of mandatory dividends. We did not ask about this.

Our sample includes 3 firms listed on Level 2, so the minimum number of yes responses for each of these rights should be 3. However, some respondents may not have been fully familiar with Bovespa's rules. A few firms provide the first two rights, even though they are not listed on Level 2. Nine firms give preferred shareholders voting rights on mergers; six do so for conflict-of-interest transactions with the controlling shareholder.

We also asked whether firms provide in their bylaws that during a freezeout, the price paid for preferred shares will be based on the economic value of the company. Eight firms provide this right (11%). This compares with 18 firms (21%) which provide this right to minority common shareholders.

We also asked whether any companies had issued a special class of preferred shares which conveys greater voting rights to its holders than other classes of preferred shares. Three companies provide these rights; for one of these, the shares are special *golden shares* retained by the government during privatization.

8.3 Minority common shareholders: freezeout and takeout rights

Table 26 summarizes the rights of minority shareholders in freezeouts[57] and sales of control. We asked whether companies provide in their bylaws for freezeouts to take place at a price based on the economic value of the company and, if so, whether minority shareholders (minority common shareholders together with preferred shareholders, if any) can vote to approve the external company which provides the valuation. Bovespa Level 2 and Novo Mercado rules require both of these rights.[58] For Level 2 firms, preferred shareholders have similar rights, as discussed in the previous subsection.

Ten companies provide for a freezeout offer to minority common shareholders based on economic value. Five of these firms are listed on Level 2 or Novo Mercado. However, only four firms give voting rights to minority shareholders to approve the external company. Two of these firms are listed on Level 2 or Novo Mercado.

[57] A freeze-out can be defined as a merger which its main purpose is to exclude minority shareholders due to the maintenance costs of a large publicly-held company. Gilson, Ronald J. Bernard S. Black. *The Law and Finance of Corporate Acquisitions*, 2^{nd} ed., 4^{th} reprint, StateplaceNew York: Foundation Press, 2002, p. 1245-1246. A freeze-out merger is also called cash merger for some authors. Allen, William T. Kraakman, Reinier. Subramanian, Guhan. *Commentaries and Cases on the Law of Business Organization*, 2^{nd} ed., StateNew York: placeAspen Publishers, 2007, p. 497-498.

[58] Bovespa Level 2 Listing Rules (2006), § 4.1.

Table 26
Minority common shareholders: freezeout and takeout rights

Sample is 86 Brazilian private firms which responded to the 2005 Brazil CG Survey

Question	Yes	% yes
If company goes private, it will make a tender offer for minority common shares, at a price based on the shares' economic value	10	12%
If yes, the external company which determines economic value must be approved by minority shareholders:	4	40%
Bylaws give takeout rights to common shareholders at 100% of per-share price paid for control	12	14%

Brazilian law requires that, in a sale of control, the acquirer must make a takeout offer to minority common shareholders, and offer at least 80% of the per-share price paid for the controlling shares.[59] IBGC recommends that this offer be at 100% of the price paid for the controlling shares; Bovespa requires this for Level 2 and Novo Mercado firms.[60] We asked whether companies go beyond the 80% legal floor. Twelve companies do so, including the 5 Level 2 and Novo Mercado firms; all of these companies provide takeout rights at 100% of the per-share price paid for control.

8.4 Preemptive rights

Table 27 reports Brazilian practice related to another important protection for minority shareholders – preemptive rights. An initial question is whether the company's charter provides for *authorized capital* (similar to authorized but unissued shares for a U.S. firm). If not, then issuance of shares requires a charter amendment, and minority shareholders will have preemptive rights.[61] Sixty-one of the responding firms (71%) have authorized capital. Of these, 45 provide preemptive rights to shareholders in all cases; another 8 firms do so some of the time. If we combine firms which have no authorized capital and firms which have authorized capital but also provide preemptive rights, de facto preemptive rights are the norm, provided by 70 firms (81%) in all cases, and another 8 firms (9%) in some cases.

[59] Law 6040/76, Art 254-A.

[60] IBGC Code of Best Practice of Corporate Governance (2003) § 1.6; Bovespa Novo Mercado Listing Rules 2006), § 8.1.

[61] Law 6040/76, arts. 171-172.

8.5 Arbitration and lawsuits

Until recently, Brazil did not have specialized business courts. Rio and Sao Paulo have recently created these courts, but the Sao Paulo court is limited to bankruptcy and financial restructuring. How effective these courts will be remains uncertain. In most instances, the judicial process moves slowly, and judges often have little experience in corporate issues. As a way around these problems with the court system, CVM and IBGC recommend that companies provide in their bylaws that disputes between shareholders and the company or between controlling shareholders and minority shareholders will be resolved through arbitration.[62] Bovespa requires that Level 2 and Novo Mercado companies provide for arbitration of disputes with shareholders, using a Bovespa-sponsored Market Arbitration Panel.[63]

In practice, arbitration is not popular, except as part of a Level 2 or Novo Mercado listing. The five Level 2 or Novo Mercado companies in our sample provide for arbitration, but only one other firm does so.

We also asked companies about the number of lawsuits (or arbitration complaints) filled by minority shareholders in the last two years. Most firms (74 firms; 89%) report no lawsuits; 5 firms (6%) report one lawsuit, and 4 firms (5%) report two or more.

8.6 Free float

Bovespa requires firms listed on Level 1 and higher to maintain free float (shares held by minority shareholders divided by the number of common and preferred shares) of at least 25%.[64] This rule is meant to ensure a reasonable level of liquidity for minority shares; it prevents a *creeping freezeout*, in which controllers gradually buy minority shares, which reduces liquidity and hence price for the remaining shares. We asked how many firms had free float of this level or higher; 51 firms (59%) have this level of minority ownership. We also asked whether firms disclose their free float percentage to shareholders; 53 firms (62%) report doing so.

9. Related Party Transactions

An important aspect of corporate governance for many Brazilian firms is the extent to which they engage in related party transactions of various sort. Table 27 reports responses to a variety of questions about whether these transactions exist, whether they are disclosed, and how they are approved.

CVM and IBGC recommend that related party transactions be disclosed, that they be on market terms, and that companies do not make loans to related parties.

[62]CVM Recommendations on Corporate Governance (2002) § 3.6; IBGC Code of Best Practice of Corporate Governance (2003), §1.9. Brazilian Arbitration Law 9307/96 requires that the arbitration panel reach a decision within 180 days after hearing a case.

[63]Bovespa Level 2 Listing Rules (2006), § 3.1(iv).

[64]Bovespa Level 1 Listing Rules (2006), § 3.1 (ii).

IBGC recommends that the fairness of a related party transaction should be based on an independent assessment; CVM also recommends that minority shareholders be given the opportunity to request that an independent entity assess the fairness of a related party transaction.[65] Bovespa's rules for Level 1, Level 2 and Novo Mercado require disclosure of related party transactions involving the greater of R$ 200,000 (a bit over US$100,000) or 1% of the company's net worth.[66]

In practice, only a small number of respondents reported having loans outstanding to related parties (4 firms, 5%), renting property from a related party (3 firms, 4%), or buying or selling significant amounts from or to a related party (7 firms, 8%). So far, so good, although one might suspect some underreporting of related party transactions.

A substantial majority reported that significant related party transactions are disclosed to shareholders (59 firms; 69%). It is unclear how to interpret the remaining responses – some firms could have answered no because they have no related party transactions to disclosure, rather than because they do not or would not disclose such a transaction.

Table 27
Related party transactions

Sample is 86 Brazilian private firms which responded to the 2005 Brazil CG Survey

			Yes	% yes
Existence and Disclosure				
Has the company lent money to related parties			4	5%
Does the company rent property from a related party			3	4%
Does the company buy or sell a significant amount of goods or services to or from a related party			7	8%
Are the details of significant related party transactions disclosed to shareholders			59	69%
Approval of Related Party Transactions with	Director or officer		Controller	
	Yes	% Yes	Yes	% Yes
No special approval	17	20%	15	17%
Approval by the board of directors	58	67%	56	65%
Approval by nonconflicted directors	12	14%	10	12%
Approval by shareholders	8	9%	11	13%
Approval by nonconflicted shareholders	4	5%	8	9%

Matters are less satisfactory with regard to approval of related party transactions. We asked separately about transactions with a director or officer, and transactions with a controlling shareholder. Table 28 reports the responses – the approval procedures were similar for both groups. One might think that at a minimum, significant related party transactions should be approved by a nonconflicted decisionmaker – nonconflicted directors, and perhaps nonconflicted shareholders. This is not the norm. Only about two-thirds of the responding firms report that they require board approval. Of the remaining firms, about half expressly answered that they had no special procedures for approval of related party transactions.

[65] CVM Recommendations on Corporate Governance (2002) § 3.4; IBGC Code of Best Practice of Corporate Governance (2003) § 6.2.1.

[66] Bovespa Level 1 Listing Rules (2006), § 6.8.

Moreover, as we saw in Section 5, many Brazilian boards have few or no independent directors. Only 12 firms (14%) report that nonconflicted directors approve significant related party transactions. Only 8 firms require shareholder approval and of these, only four firms require approval by nonconflicted shareholders.[67]

10. Disclosure

10.1 Financial statements

We asked firms about a variety of disclosures of financial information which go beyond those required by Brazilian law. For example, Brazilian law contains detailed requirements for financial statements, but does not require either a statement of cash flows or quarterly consolidated financial statements (it does require annual consolidated statements).[68] Bovespa requires additional financial disclosure for firms on its higher listing levels, including:

- A statement of cash flows (Level 1 and higher);
- International Financial Reporting Standards (IFRS) or U.S. GAAP financials, with a note reconciling these statements to Brazilian financial statements (Level 2 and Novo Mercado);
- English language financial statements (Level 2 and Novo Mercado); and
- Consolidated quarterly financial statements (Level 2 and Novo Mercado).[69]

We asked firms about each of these, and also about whether they provide textual discussion of financial results, similar to the *management's discussion and analysis* required by U.S. securities rules for U.S. companies. Table 28 indicates how many firms provide each disclosure. Some firms do so as part of overall compliance with a set of Bovespa listing level rules, but some do so separate from any Bovespa standards. The table indicates the total number of firms which provide particular disclosures, and also the number which do so separate from compliance with Bovespa listing level rules.

Almost half (47%) provide English language financial statements. In addition, 37 companies (43%) include a statement of cash flows in their financial statements, and 26 firms (30%) provide IFRS or U.S. GAAP financials. In addition, a large majority of companies (83%) provide textual, *MD&A* discussion of their financial results. In many cases, firms provide disclosures even though the firm does not need to do so as part of a package of Bovespa listing level requirements. Some of these firms cross-listed, and are complying with cross-listing requirements.

[67] Law 6404/76, art. 115, provides that voting rights are considered to have been abused if a shareholder exercises them with the intent to obtain private advantage. Thus, in practice, if a shareholder vote is required to approve a related party transaction, approval by nonconflicted shareholders is required.

[68] Law 6404/76, arts. 176-188 contains requirements for financial statements.

[69] Bovespa Level 1 Listing Rules (2006), § 4.2; Level 2 Listing Rules (2006), § 6.1-6.2.

At the same time, some firms are choosing which additional disclosures to provide. For example, of the 26 firms which provide IFRS or U.S. GAAP financial statements, 5 do so to comply with Bovespa listing level requirements, 16 do so to comply with cross-listing requirements, and the remaining 5 do so *other than* in connection with Bovespa listing or cross-listing requirements. At the same time, only 11 firms reconcile their IFRS or U.S. GAAP financial statements to their Brazilian financial statements. Perhaps these firms judge that investors can do this for themselves. Consolidated financial statements are also not popular. Only 17 firms (20%) provide consolidated quarterly financial statements.

Table 28
Financial statements

Sample is 86 Brazilian private firms which responded to the 2005 Brazil CG Survey

Area	Bovespa rule	Yes	% yes	Yes not due to listing level at Bovespa
Company provides financial statements in English	Level 2	41	47%	35
Financial statements include a statement of cash flows	Level 1	37	43%	14
Company provides financial statements which comply with IFRS or U.S. GAAP	Level 2	26	30%	20
IFRS or U.S. GAAP financial statements are reconciled to Brazilian financial statements	Level 2	11	42%	5
Company publishes consolidated quarterly financial statements	Level 2 (if has consolidated annual statements)	17	20%	11
Financial reports include discussion and analysis of factors that most influenced results and company's main risk factors (similar to U.S. MD&A disclosure)		71	83%	
Company officers hold regular meetings with analysts	Level 1 (annual meetings)	53	62%	

A majority of firms (53 firms, 62%) report that company officers meet regularly with analysts. Bovespa requires firms on Level 1 or higher to hold at least an annual meeting with analysts.[70] Of the firms which do not meet regularly with analysts, some may be small enough so that they have little no analyst coverage.

11. Website Disclosure

One important means of disclosure is through company websites. We asked whether companies provide different types of information on their websites. Table 29 summarizes the responses, and also whether similar information is available from the CVM website. About half of the firms (40 firms; 47%) have English language disclosure on their websites. Of these, 32 also provide English language financial statements.

Consider financial disclosure first. Two-thirds of the firms (58 firms) provide annual financial statements on their website; most of these (51 firms) also provide

[70] Bovespa Level 1 Listing Rules (2006), § 4.4, Bovespa Level 2 Listing Rules (2006), § 6.6.

quarterly financial statements. This information is also available from the CVM website, but in a different, CVM-specified format. A similar number of firms provide a written annual report to shareholders. Almost 50% provide press releases.

Table 29
Information on company website

Sample is 86 Brazilian private firms which responded to the 2005 Brazil CG Survey

Process	Yes	% yes	On CVM website
English language disclosure	40	47%	
Financial and related information			
Annual financial statements	58	67%	yes
Quarterly financial statements	51	59%	yes
Annual report to shareholders	53	62%	
Press releases	42	49%	yes
Stock prices (or link to site with this information)	35	41%	
Shareholder meetings and related information			
Notice of upcoming shareholder meetings	36	42%	
Discussion of the results of shareholder meetings	20	23%	
Background information about board members	27	31%	yes
Bylaws and minutes			
Bylaws	37	43%	yes
Minutes of meetings of the board of directors	26	30%	
minutes of meetings of the fiscal board*	6	19%	
Other information			
Material changes in facts relevant to share price	51	59%	yes
Other information material to shareholders	48	56%	yes
None of the above	15	18%	

*There are 32 firms with a permanent fiscal board. See Part VII.B.

For shareholder meetings, 36 firms (42%) provide notice of the meeting on the company website; a smaller number (20 firms; 23%) post the voting results after the meeting. A fair number of firms post their bylaws (37 firms; 43%). Fewer firms post minutes of board meetings. However, it is not clear that posting minutes of board meetings should be seen as part of good governance. One concern is that if firms know they will need to post the minutes, they will ensure that the minutes are bland – and hence of limited value to shareholders. Moreover, knowledge that the minutes will be posted might chill boardroom discussion. A similar analysis applies to minutes of fiscal board meetings, which are provided by 6 firms. Finally, 15 firms (18%) have quite uninformative websites, which contain none of the information we asked about.

12. Control and Shareholder Agreements

12.1 Control

Almost all Brazilian firms have a controlling shareholder or group. The type of control varies. Twenty firms (24%) are directly controlled by a single shareholder. Another 16 are controlled by a non-public company and 5 by another public company, which itself likely has a controlling shareholder or group. Another 10 firms are controlled by a family, and 30 by another group of shareholders. Three firms indicated “other” as the form of control, and only one firm indicated that it had no

controlling shareholder or group. Table 30 summarizes the nature of control of the firms in our sample.

Table 30
Controlled firms

Type of control, for 85 Brazilian private firms which responded to the questions on type of control in the 2005 Brazil CG Survey

	Private firms	
Type of control	No. of firms	% 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%

12.2 Shareholder agreements

In many firms with a controlling shareholder or group, a single person has effective control. But in some firms, the control group is diffuse enough so that its members find it useful to enter into a shareholder agreement to ensure cohesive voting for directors, and perhaps on other issues. Brazilian law facilitates enforcement of these agreements. Under 2001 amendments to Brazilian corporate law, a shareholder agreement, if filed with the company and made publicly available, is binding on the company. Votes at a shareholder meeting by members of the control group, which violate the agreement, will not be counted. Agreements which are not registered with the company are treated as private agreements, enforceable between the parties to the agreement, but not against the corporation or its directors.

In addition, directors who are elected under a filed agreement are required to vote in accordance with the terms of the agreement. There is no explicit exception for cases where doing so would conflict with their judgment on what is best for the firm or best for non-controlling shareholders.[71] Yet a separate, older provision of Brazilian law requires a director to support the company's best interests, *even at the expense of those who elected him*.[72] The tension between these provisions has not yet been addressed by the Brazilian courts. Because the rule on enforcement of shareholder agreements is fairly recent, the number of companies at which shareholder agreements are used, and the scope of these agreements, is likely still in flux. Gorga (2009) studies the specific provisions of Brazilian shareholder agreements.

IBGC and CVM both recommend that shareholder agreements should be available to all shareholders. IBGC also recommends that the agreement should not

[71] Law 6404/76, art. 118.
[72] Law 6406/76, art. 154 § 1.

limit the voting powers of directors or include provisions on selection of officers (thus leaving this to the board).[73]

Table 31 summarizes the responses relating to shareholder agreements. A substantial minority of firms (36 firms; 42%) have a shareholder agreement among the members of the controlling family or group. Of these firms, two-thirds (24 firms) indicated that the shareholder agreement was used to ensure control. Election of directors is a common subject of such an agreement – 22 firms indicated that one or more directors were elected in accordance with the agreement. Of these firms, roughly half (12 firms) rely on the shareholder agreement to elect four or more directors; in each case these directors are a majority of the board.

Table 31
Shareholder agreements

Sample is 86 Brazilian private firms which responded to the 2005 Brazil CG Survey

	Yes	% yes
There are one or more shareholder agreement(s) among a family or other shareholder group	36	42%
For firms with a shareholder agreement:		
Control is ensured through the agreement(s)	24	67%
The agreement governs the election of one or more directors	22	61%
The shareholder agreement(s) are registered with the company	33	92%
Shareholder agreements are not registered with the company, but are disclosed to minority shareholders	1	33%

Of the 36 firms with agreements, 33 (92%) have filed them with the company, thus taking advantage of the power to enforce the agreement against the company and its directors. For the remaining 3 firms, the contents of the agreement are disclosed at one firm. At the remaining two firms, the terms of the agreement are not publicly known.

13. Director and Executive Compensation

Our survey provides us with only limited information on compensation of directors and executives. We asked questions about specific levels of compensation, but in contrast to the remainder of the questionnaire, there was substantial reluctance to respond.

We did obtain reasonably complete responses to more general questions. These are summarized in Table 32. Firms rarely use stock options. Only 12 firms (14%) provide them to officers; only two firms provide them to non-executive directors. No firms pay their non-executive directors partly on shares. Four firms provide retirement benefits to non-executive directors.

[73] IBGC Code of Best Practice of Corporate Governance (2003) § 1.3; CVM Recommendations on Corporate Governance (2002) § 1.3.

IBGC recommends that directors should receive incentives to align their interests with those of shareholders. However, IBGC does not detail how this could be done, other than a peculiar recommendation that directors be paid *on the same hourly basis used for the CEO, including bonuses and benefit commensurate with the time effectively dedicated to her function*. IBGC similarly recommends that executive compensation should be linked to results, though again without specifying how. Finally, IBGC recommends that the company disclose the compensation of directors and officers *on an individual or aggregate basis*.[74]

Table 32
Director and officer compensation

Sample is 84 Brazilian private firms which responded to the 2005 Brazil CG Survey and answered the general questions on compensation

Question	Yes	% yes
Officers receive stock options	12	14%
Non-executive directors receive stock options	2	2%
Non-executive directors are paid partly with shares	0	0
Non-executive directors receive retirement benefits	4	5%

14. Conclusion

In this paper we provide a detailed overview of the corporate governance practices of Brazilian private firms (firms without majority ownership by the government or by a foreign company). The overview is based primarily on an extensive 2005 survey of governance at 116 Brazilian public firms, including 88 Brazilian private firms. We identify areas where Brazilian corporate governance is relatively strong and weak, and areas where regulation might usefully be relaxed or strengthened.

Board independence is an area of notable weakness: The boards of most Brazilian private firms are comprised entirely or almost entirely of insiders or representatives of the controlling family or group. Many firms have zero independent directors. At the same time, minority shareholders have legal rights to representation on the boards of many firms, and this representation is reasonably common.

Financial disclosure lags behind world standards. Brazilian accounting standards do not require either a statement of cash flows or quarterly consolidated financial statements, and only a minority of firms provide these, generally in connection with a listing on Bovespa Level 1 or higher, or cross-listing on a foreign exchange. However, about half of the respondents provide English language financial statements and an English language version of their website.

Audit committees are uncommon. However, many Brazilian firms use a fiscal board as an alternate approach to ensuring financial statement accuracy. Most firms have either an audit committee or a permanent or effectively permanent fiscal

[74] IBGC Code of Best Practice of Corporate Governance (2003) §§ 2.21 (director compensation); 3.9 (executive compensation); 3.5.2 (compensation disclosure).

board. The relative advantages of audit committee versus fiscal board, and whether it makes sense to have both require further study.

A high percentage of Brazilian private firms (74 firms, 84%) have issued non-voting preferred shares, as a way for controllers to raise equity capital without diluting their voting control.

Brazilian law requires takeout rights for minority common shareholders at 80% of the price paid for controlling shares. A minority of firms goes beyond this legal minimum and provides takeout rights to minority common shareholders at 100% of the price paid for controlling shares, takeout rights for preferred shareholders, or both. Controlling shareholders often use shareholders agreements to ensure control.

Our survey provides a snapshot of Brazilian governance in 2005. However, governance practices in Brazil are changing rapidly, fueled by new IPOs on Bovespa Level 2 and Novo Mercado, and to a lesser extent by older public firms upgrading their governance. The number of Level 2 and Novo Mercado firms has grown from 14 at year-end 2004 (5 of which are in our sample of Brazilian private firms), to 103 at year-end 2008.

References

Alexandru, P. (2008). Novo Mercado versus Romania's Transparency Plus Tier – A mirror image? *Global Corporate Governance Forum Focus*, 5:41–55.

Ararat, M. & Burcin Yurtoglu, B. (2007). Different approaches to differentiating 'better governed' companies: Market segmentation in BOVESPA and rating based indexing in ISE. Working paper available at `http://ssrn.com/abstract=989806`.

Baker, E., Gottesman, A., Morey, M., & Godridge, B. (2007). Corporate governance ratings in emerging markets: Implications for market valuation, internal firm performance, dividend payouts and policy. Working paper available at `http://fordham.bepress.com/crif_seminar_series/5/`.

Balasubramanian, N., Black, B., & Khanna, V. (2009). Firm-level corporate governance in emerging markets: A case study of India. Working paper available at `http://ssrn.com/abstract=992529`.

Bebchuk, L. A., Coates, J. C., & Subramanian, G. (2002). The powerful antitakeover force of staggered boards: Theory, evidence, and policy. *Stanford Law Review*, 54:887–951.

Bennedsen, M., Nielsen, K. M., & Nielsen, T. V. (2008). Private contracting and corporate governance: Evidence from the provision of tag-along rights in an emerging market. Working paper available at `http://cei.ier.hit-u.ac.jp/Japanese/database/documents/WP2008-2.pdf`.

Black, B., Love, I., & Rachinsky, A. (2006). Corporate governance indices and firms' market values: Time-series evidence from Russia. *Emerging Markets Review*, 7:361–379.

Brazilian Institute for Corporate Governance (IBGC) (2003). Code of best practice of corporate governance. Available at `http://www.ibgc.org.br/CodeBestPractices.aspx`.

Bruno, V. & Claessens, S. (2006). Corporate governance and regulation: Can there be too much of a good thing? Working paper available at `http://ssrn.com/sabstract=956329`.

Carvalhal-da Silva, A. L. & Subramanyam, A. (2007). Dual-class premium, corporate governance, and the mandatory bid rule: Evidence from the brazilian stock market. *Journal of Corporate Finance*, 13:1–24.

Choi, J. J., Won Park, S., & Sehyun Yoo, S. (2007). The value of outside directors: Evidence from corporate governance reform from Korea. *Journal of Financial and Quantitative Analysis*, 42:941–962.

Da Silveira, A. D. M., Barros, L. A. B. C., & Famá, R. (2004). Determinants of corporate governance quality of Brazilian listed companies. Annals of the fourth annual meeting of the Brazilian Finance Society, Rio de Janeiro. Available at `http://virtualbib.fgv.br/dspace/handle/10438/1330` (in Portuguese).

Da Silveira, A. D. M., Leal, R. P. C., Carvalhal-Da-Silva, A. L., & Barros, L. A. B. C. (2009). Evolution and determinants of firm-level corporate governance quality in Brazil. *Revista de Administração*, 44(3):173–189. Working paper also available at `http://ssrn.com/abstract=995764`.

De Carvalho, A. G. (2000). Ascensão e declínio do mercado de capitais no Brasil: A experiência dos anos 90. *Economia Aplicada*, 4:595–632.

De Carvalho, A. G. (2002). Governança corporativa no Brasil em perspectiva. *Revista de Administração*, 37(3):19–32.

De Carvalho, A. G. & Pennacchi, G. G. (2009). Can a stock exchange improve corporate behavior? Evidence from firm's migration to premium listings in Brazil. Working paper, earlier version at `http://ssrn.com/abstract=678282`.

Drobetz, W., Schillhofer, A., & Zimmerman, H. (2004). Corporate governance and expected stock returns: Evidence from Germany. *European Financial Management*, 10:267–293.

Dutra, M. G. L. & Saito, R. (2002). Conselhos de administração: Análise de sua composição em um conjunto de companhias abertas. *Revista de Adminstração Contemporânea*, 6(2):9–27.

Dyck, A. I. J. & Zingales, L. (2004). Private benefits of control: An international comparison. *Journal of Finance*, 59:537–600.

Gorga, E. (2006). Culture and corporate law reform: A case study of Brazil. *University of Pennsylvania Journal of International Economic Law*, 27:803–905.

Gorga, E. (2009). Changing the paradigm of stock ownership from concentrated toward dispersed ownership? Evidence from Brazil and consequences for emerging countries. *Northwestern Journal of International Law & Business*, 29(2):439–554.

Leal, R. P. C. (2007). Práticas de governança e valor corporativo: Uma recente revisão da literatura. In Carvalhal-Da-Silva, A. L. & Leal, R. P. C., editors, *Governança Corporativa, Evidências Empíricas No Brasil*, pages 3–21. Editora Atlas, São Paulo.

Leal, R. P. C., Carvalhal-Da-Silva, A. L., & Valadares, S. M. (2000). Ownership, control and corporate valuation of Brazilian companies. Proceedings of the Latin American Corporate Governance Roundtable, São Paulo.

Nenova, T. (2003). The value of corporate votes and control benefits: A cross-country analysis. *Journal of Financial Economics*, 68:325–351.

Nenova, T. (2005). Control values and changes in corporate law in Brazil. *Latin American Business Review*, 6:1–37.

Patel, S. A., Balic, A., & Bwakira, L. (2002). Measuring transparency and disclosure at firm level in emerging markets. *Emerging Markets Review*, 3(4):325–337.

Santana, M. H. (2008). The novo mercado. *Focus Report of Global Corporate Governance Forum*, 5:1–39.

Valadares, S. M. (2002). Estimativa de valor de controle no Brasil. In Bonomo, M., editor, *Finanças Aplicadas Ao Brasil*. Editora Fundação Getulio Vargas, Rio de Janeiro.

Valadares, S. M. & Leal, R. P. C. (2000). Ownership and control structure of Brazilian companies. *Abante*, 3(1):29–56.

Zheka, V. (2006). Does corporate governance causally predict firm performance? Panel Data and Instrumental Variables Evidence. Working paper available at `http://ssrn.com/abstract=877913`.

Appendix

Table A.1
Bovespa listing levels and disclosure and governance requirements

Main aspects of Bovespa listing levels (X = required)	Regular	Level 1	Level 2	Novo Mercado
Disclosure requirements				
Agreements between company and related parties.	no	X	X	X
Transactions in company by employees, directors, fiscal board members.	no	X	X	X
Shares held by controllers, directors, and members of the fiscal board.	no	X	X	X
Securities issued by the company.	no	X	X	X
Statement of cash flows.	no	X	X	X
Consolidated quarterly financial statements (if firm provides consolidated annual statements).	no	X	X	X
Financial statements which comply with US GAAP or IFRS, note reconciling these to Brazilian statements.	no	no	X	X
English language financial statements	no	no	X	X
Meetings with analysts (at least annually)	no	X	X	X
Annual calendar of corporate events	no	X	X	X
Only common shares allowed	no	no	no	X
Free-float of at least 25% of outstanding shares	no	X	X	X
Public offerings have to use mechanisms to favor capital dispersion.	no	X	X	X
Board of Directors				
Minimum number or percentage of independent directors required	no	no	20%	20%
Non-staggered board terms, maximum two years	no	no	X	X
Corporate rules				
Preferred shares vote together with common shareholders on selected issues (including mergers spin-offs, contracts between the company and related firms).	no	no	X	not relevant
Freezeout offer based on economic value of firm, determined by independent valuation	no	no	X	X
Minority common shareholders have tag-along rights on sale of control, at 100% of price paid for controlling shares.	no	no	X	X
Preferred shareholders have tag-along rights on sale of control, at at least 80% of the price paid for controlling shares.	no	no	X	not relevant
Disputes with shareholders submitted to arbitration.	no	no	X	X