

LAD CASE STUDY

Access to Financial Resources for Local Companies: Revitalizing Brazil's Stock Exchange

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LAD

ABOUT LAD

The Leadership Academy for Development (LAD) trains government officials and business leaders from developing countries to help the private sector be a constructive force for economic growth and development. It teaches carefully selected participants how to be effective reform leaders, promoting sound public policies in complex and contentious settings. LAD is a project of the Center on Democracy, Development and the Rule of Law, part of Stanford University's Freeman Spogli Institute for International Studies, and is conducted in partnership with the Johns Hopkins School of Advanced International Studies. LAD gratefully acknowledges support from the Omidyar Network.

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Introduction

As Maria Helena Santana and Gilberto Mifano waited anxiously in September 2000 to meet with José Luiz Osório, Brazil's Chief Securities Commissioner, they knew they could only present a discouraging picture of Brazil's stock market. Santana and Mifano were senior executives of BOVESPA, Brazil's largest stock exchange. They were meeting with Osório at Brazil's securities and exchange commission, the Comissão de Valores Mobiliários (CVM; see exhibit 1 for glossary of terms and abbreviations), to discuss how to reverse the persistently poor performance of Brazil's stock market.

BOVESPA had commissioned a report by a team of Brazilian academics and economists to analyze the challenges and opportunities for reform of Brazil's stock market. The so-called Mendonça de Barros report painted a very discouraging picture: There had been no initial public offerings (IPOs) by Brazilian companies in several years, trading volume was declining, some leading firms were "de-listing" their shares from BOVESPA, and many of the largest Brazilian companies were choosing to raise capital in New York rather than use the local stock market. Brazil's equity market was truly at a crossroads. Without rapid improvements to its regulations and governance, the stock exchange would become obsolete.

The consequences of losing a functioning stock market would be dire for the country. Existing Brazilian companies would have no domestic source of capital, aside from government-subsidized loans, severely limiting their ability to grow, expand production and generate employment. Newer companies, on the other hand, would have even greater difficulty attracting much needed capital. Finally, Brazilians would be denied the alternative of investing their savings in the domestic stock market. Not only would this significantly restrict their ability to diversify their financial holdings, but it would also deprive the Brazilian economy of an important source of capital for productive private investment.

In order to revitalize the Brazilian equity market and prevent BOVESPA from becoming obsolete, Santana and Mifano needed a reform package that would achieve the following goals:

Aaron Mihaly prepared this case under the supervision of Professors Roger Leeds and Francis Fukuyama of Johns Hopkins School of Advanced International Studies. This case was developed solely as a basis for class discussion. It is not intended to serve as historical record, a source of primary data, or an illustration of effective or ineffective management.

- Strengthen governance standards for listed companies (i.e. oversight, transparency and senior management accountability) as a means of boosting investor confidence and lowering the costs for companies raising equity capital.
- Stimulate a larger supply of equity financing by increasing IPO valuations and thereby lower the cost of equity capital for both large Brazilian firms and SMEs.
- Boost demand for equity by attracting new domestic and foreign investors.
- Increase the number of IPOs by lowering the barriers to entry for SMEs aspiring to go public.
- Restore BOVESPA's credibility so that Brazilian companies of all sizes would prefer to raise capital domestically rather than abroad.

The development of a healthy domestic equity market is an essential building block for stimulating economic growth. This reality was affirmed in a 2000 report by the International Finance Corporation (IFC) on Brazilian equity markets:

Equity markets raise financing for investment and provide diverse financing opportunities for larger firms. They . . . enhance the allocation of resources. They matter for the growth of new firms as they offer financing for new, innovative firms and exit vehicles for venture capitalists financing middle-market and new-economy firms. Across countries, more developed and more active capital markets are associated with higher rates of economic growth. And well-balanced financial systems with financial intermediation by both banks and capital markets can also absorb shocks better.

Recent improvements in Brazil's macroeconomic climate, including declining inflation and real interest rates, as well as a growing supply of domestic savings, were positive developments. (See exhibit 2.) But to ensure that these increased savings remained in Brazil and were allocated efficiently to domestic investment opportunities required a well-developed equity market.

A number of alternative approaches to stock-market reform were available to Santana and Mifano. Whichever path they chose, they needed to make a recommendation to BOVESPA's board of directors before the close of the calendar year.

Brazil's Equity Market in 2000

The São Paulo Stock Exchange—the Bolsa de Valores de São Paulo (BOVESPA)—was created in 1890, and by 2000 it was the dominate stock exchange in all Latin American: In 2000, the market capitalization of companies listed on BOVESPA was US\$229 billion, making it by far the largest exchange in Latin America. However, a range of factors impeded BOVESPA's capacity to provide sufficient capital for Brazil's growing private sector.

Low liquidity and high volatility

In terms of market capitalization and daily trading volume, BOVESPA was dominated by a very small number of Brazil's largest firms. The few companies that did raise equity capital on the exchange maintained very small public floats (the percentage of a firm's total shares

outstanding that could be freely traded on the exchange), which made the shares unattractive for investors. Santana explained:

The stock market was dominated by arbitrageurs and investors who were focused on short-term opportunities. Investors' strategies were not based on business fundamentals but rather on speculation about the prospects for short-term gains.ⁱ

Stock ownership was also extremely concentrated. Of 325 non-state-owned companies listed on BOVESPA in 1997, 203 had a single shareholder, usually a family or business group, who controlled more than 50 percent of voting capital. Even in companies without a single controlling shareholder, the largest shareholder still owned an average of 32 percent of voting capital. On the entire stock exchange, the top five shareholders of each listed company owned an average of 82 percent of voting capital. This imbalance contrasted sharply with stock exchanges in more developed countries, where shareholdings were broadly diversified among the investing public.

Proliferation of non-voting preferred shares

According to the Brazilian corporate law, public companies were allowed to issue equity equivalent to two-thirds of their capital stock in the form of non-voting "preferred" shares. This meant a shareholder could theoretically control a company with as little as 50 percent of the remaining third of voting common shares, or 17.5 percent of total capital. Therefore, companies had an incentive to issue non-voting preferred shares so that the controlling shareholder could raise equity capital without relinquishing control of the company. With no rights to vote on management decisions, minority shareholders had little incentive to invest in the equity market.

High cost of capital for issuers

Fewer and fewer companies considered Brazil's equity markets an attractive option for raising capital. Between 1995 and 2000, there were only eight IPOs on BOVESPA, and many companies that had been listed opted to leave the exchange completely (see exhibit 3). Stock valuations were low, due to investors' heightened perceptions of risk, with price-to-earnings ratios in Brazil lower than in developed markets and many other emerging markets. As Mifano explained,

When I talked with the families and business groups that controlled public companies, I would ask them, "Why don't you issue stock? Why don't you raise funds from the equity market?" Their answer was, "At the price investors are willing to pay, there's no incentive for me." There was a huge gap between what a company owner was willing to receive and what an investor was willing to pay for shares in a company.ⁱⁱ

Santana elaborated on the severity of the problem: "Within the BOVESPA board, there was this perception that we couldn't survive unless we broke this vicious cycle in which investors felt unprotected, causing them to discount the price they were willing to pay for shares. And this scenario eliminated any incentive for companies to list their shares on the exchange."ⁱⁱⁱ

Flight to U.S. exchanges

The lack of liquidity and high cost of capital led an increasing number of Brazilian companies to bypass BOVESPA and raise capital abroad, usually on the New York Stock Exchange (NYSE) in the form of American Depositary Receipts (ADRs). The number of Brazilian companies with ADR programs increased from 41 in 1996 to 76 in 2000 and represented the equivalent of 20 percent of the total market capitalization of BOVESPA (see exhibit 4). By March 2000, trading volume in Brazilian ADRs exceeded BOVESPA's trading volume. If this migration away from the BOVESPA continued, many believed that the domestic stock exchange would soon be obsolete as a source of capital. This in turn would severely restrict the private sector's contribution to the overall economy.

Inaccessibility for small and medium firms

While Brazil's largest companies could choose to bypass the BOVESPA and raise capital on the NYSE or other foreign exchanges it was virtually impossible for SMEs to take advantage of these alternative external sources of capital. As in most countries, Brazilian SMEs were the primary source of new employment generation, innovation, growth of exports and other key indicators of private sector vitality. But denied access to the domestic capital they required to grow and compete, even the most well established SMEs were stymied.

Poor minority shareholder protection

To make matters worse, the regulatory framework provided minimal protection for minority shareholders. In 1997, on the eve of many of the largest privatizations under President Cardoso, Brazilian lawmakers eliminated "tag-along rights," a standard clause in shareholder agreements stipulating that whenever a company issues new stock, the minority shareholders have the same rights as the controlling shareholder. By eliminating this standard protection, minority shareholders were at a distinct disadvantage when the government, as controlling shareholder, began to privatize state-owned enterprises (SOEs).

Without tag-along rights, individual minority shareholders, both Brazilian and foreign, were forced to sell their shares in companies being privatized (SOEs) at prices that were much lower than the government, which was the controlling shareholder. This unequal treatment of minority shareholders exemplified the consequences of sub-standard corporate governance practices, and deterred many investors from participating in Brazilian equities.

Corporate Governance in Brazil

All countries with well-developed stock exchanges have clearly defined corporate governance standards that companies must satisfy before they are permitted to issue shares. In Brazil corporate governance was largely an unknown concept until 1995, when a coalition of 36 businesspeople, corporate board members, executives, consultants and scholars created the Brazilian Institute of Corporate Directors (IBCA) with the goal of strengthening corporate governance standards. In 1999 the IBCA renamed itself the Brazilian Institute of Corporate Governance (IBGC). IBGC co-founder Sandra Guerra described the challenge of overcoming the pervasive skepticism in Brazil about corporate governance:

There was no awareness of corporate governance, no understanding at all. People felt that practices of good governance were much more related to mature markets like the U.S. “This is not for us,” I remember people telling me, “We have a totally different environment here in Brazil. Corporate governance is for American shareholders who fear their companies’ managers have too much power or are overcompensated. We don’t have that problem here because our management and controlling shareholders are one and the same.”^{iv}

In 1999, the IBGC addressed the corporate governance problem by publishing its *Code of Best Practice of Corporate Governance*, which outlined internationally accepted standards of good corporate governance. Some of the most important—and radical by Brazilian standards—practices^v included:

- **One share-one vote:** The right to vote should be ensured to all shareholders. Non-voting preferred shares are a clear violation of this principle.
- **100 percent tag-along rights:** In the event of a transfer of company control, the offer to purchase shares should be made to all shareholders under the same terms and conditions, thereby preventing majority shareholders to benefit at the expense of minority shareholders.
- **Composition and term limits of boards of directors:** The board of directors should include a substantial number of independent directors who are neither significant shareholders nor employed by the company; directors’ terms should not exceed two years, and reelection should not be automatic; the roles of chairman and CEO should be separated.
- **Disclosure and regular reporting:** Management must ensure that all shareholders are regularly provided with information materially relevant to the company’s performance, including disclosure of related-party transactions^{vi}; the company should regularly provide consolidated financial statements that follow internationally accepted financial reporting standards.
- **Independent auditing:** Every firm should have its financial statements audited by independent external auditors tasked with determining whether they adequately reflect the company’s true financial situation.
- **Arbitration:** Conflicts among shareholders, administrators and the company should be resolved through mediation, or failing that, through arbitration.

This last point regarding arbitration represented a monumental improvement over how corporate disputes were traditionally resolved through the Brazilian judicial system. Brazil ranked 42nd in the world in terms of the efficiency of its judicial system, below such countries as Zimbabwe and Nigeria,^{vii} and Brazilians’ perceptions reflected this. As one contributor to the BOVESPA-commissioned Mendonça de Barros report observed,

In Brazil, we always had very [little] confidence in the judicial system. Everyone knew that you could hire lawyers and draw out a case for years and years; even ten years . . . a case could never end. After twenty years, one loses interest in the outcome of the case. This made most private contracts [lack] any credibility.^{viii}

With arbitration, both parties had to agree upfront to accept the arbitration panel's decision, and the process usually had to be completed within 6 months). Also, the arbitration panel was composed of BOVESPA-elected arbitrators with the requisite capital-markets expertise, and each party would be allowed to select a portion of the arbitrators, thus increasing the likelihood that the final decision would be accepted by both parties.

The important work of the IBGC was reinforced and the level of public awareness of corporate governance issues was raised by a number of developments. For example, in April 2000, the IFC and OECD (Organisation for Economic Co-operation and Development) organized the first Latin American Roundtable on Corporate Governance in São Paulo, which was attended by a broad range of stakeholders committed to strengthening capital markets. Then, a few months later, management consultancy McKinsey & Company published the results of its first Investor Opinion Survey, revealing that the great majority of investors are willing to pay a higher price for shares of a well-governed company than for those of a poorly governed company.^{ix} In Brazil, the share price premium investors were willing to pay for companies with "good governance" was as high as 23 percent more than for companies with a reputation for sub-standard governance (see exhibit 5).

Major Stakeholders in Reform

As Santana and Mifano considered how best to improve corporate governance and revitalize BOVESPA, they had to be extremely sensitive to the vested interests of major stakeholders, including some who were potential opponents of reform.

Existing issuers

The vast majority of the 467 companies listed on BOVESPA in 2000 were either family owned or tightly controlled by one owner or group. These issuers benefited from the existing regulatory environment because they could issue non-voting preferred shares that would not risk diluting their control. Most issuers were content with the status quo, and would likely be unenthusiastic about any reforms that threatened their privileged position.

Whatever reforms were recommended would have to balance the interests of controlling shareholders, who worried about losing control over their companies or making too many concessions to minority shareholders, with other stakeholders who were strong advocates of greater transparency and fair treatment for all shareholders.

Foreign investors

BOVESPA would only improve its performance if foreign institutional and individual investor participation increased significantly. There were simply not enough domestic investors to provide the liquidity and volume that was needed to reverse the downward slide.

As minority investors with limited protection, foreign investors were increasingly reluctant to invest in BOVESPA-listed companies. They bitterly recalled their second-class status in pre-privatized Brazilian companies in the mid-1990s, when the government rescinded tag-along rights, lowering the price of their shares. BOVESPA executive director Gilberto

Mifano recalled “After being expropriated, foreign investors would complain to me, ‘There’s no trust. It’s not possible to invest here.’”^x

Investors were also distrustful of the reliability of Brazilian companies’ financial statements because there was no requirement to comply with international reporting standards (such as U.S. GAAP or IFRS), to provide consolidated statements, or disclose related-party transactions with potential conflicts of interest. BOVESPA reforms had to provide assurance to foreign investors that minority shareholders would be protected.

Underwriters

Underwriters—namely, Brazil’s investment banks—are highly influential players in Brazil’s equity market. As in most countries, when a Brazilian company considers going public it hires an investment bank to structure, price and sell the new security offering to investors. Issuing firms are heavily influenced by the advice their underwriters provide.

Investment bankers frequently advised companies to issue non-voting preferred shares, which according to Brazilian corporate law allowed company owners to raise equity while retaining control over common stock shareholders. For BOVESPA reform to succeed, underwriters would have to be willing to advise companies that they would receive attractive valuations even if they gave up the use of preferred shares and the implied control that came with them.

Central bank

Armínio Fraga, president of the central bank, was a strong and influential advocate in favor of BOVESPA reforms, recognizing the clear linkage between a healthy equity market and the country’s economic and social development. He explained, “people [must] have a reasonable understanding that a company can go public, raise some capital, and then use that capital to start a business or to grow a business that will invest, that will hire people, and that will train people.”^{xi} As central bank president, Fraga understood very well that it was in Brazil’s national interest for BOVESPA to undertake reforms that would make the country an attractive destination for foreign capital. Moreover, he was outspoken in his belief that the role of the private sector as an engine of growth would be significantly enhanced if the barriers to entry on the stock exchange were lower for smaller Brazilian companies seeking to raise capital.

Comissão de Valores Mobiliários

Another strong institutional advocate for reform was the CVM, the government’s primary regulator of all stock market activities. The CVM president explained that his priorities were “to reform the law to improve corporate governance, to induce investment in Brazil, to improve transparency through one set of accounting rules, and to bolster enforcement. There is no regulator without enforcement . . . the enforcer has to show it has teeth.”^{xii} As the principal federal body charged with regulating and supervising Brazil’s equity market, CVM’s support for any reform effort was essential.

BOVESPA’s Options

Santana and Mifano considered three possible paths to achieving significant BOVESPA reform. All involved strengthening governance standards, but the means of doing so varied widely.

Option 1: Legislative reform

BOVESPA could support the process of legislative reform already underway. Emerson Kapaz, a key member of the Brazilian Chamber of Deputies, argued passionately for the legislature to pass a new law that included the following provisions:

- Companies cannot issue more than 50 percent of their equity as non-voting preferred shares.
- Mandatory tag-along rights should be reestablished, at a price not below the economic value of the firm.
- Minority shareholders should have the right to elect at least one member of the board of directors.
- If a company opts to de-list its shares, it must offer to buy all outstanding stock at a price not below the economic value of the firm.
- Disputes among controlling shareholders, minority shareholders, and the company should be resolved through arbitration.

These amendments to the existing Corporate Law would raise corporate governance and transparency standards for all public companies in Brazil, and the standards would carry the potency and enforceability of federal law.

For those skeptical of BOVESPA's ability to regulate itself, this legislative option was clearly the best option. By supporting improved federal legislation, BOVESPA would bear little risk or cost on its own. On the other hand, this option entailed BOVESPA ceding a substantial degree of control over the outcome of the reform process to Congress, and enforcement of corporate government standards would rest with federal regulators rather than BOVESPA.

Another disadvantage of this option was time and uncertainty. It would take many months or even years for the proposed legal reforms to make their way through both houses of the Brazilian congress, if they made it through at all. With BOVESPA truly at a turning point, these likely delays could prove fatal. In addition, legislators were subject to intense lobbying by powerful vested interests that opposed reform. As Sandra Guerra explained, "The conservative companies were stronger and better organized than those of us fighting for better corporate governance."^{xiii}

This legislative approach did not preclude BOVESPA from simultaneously pushing its own reform agenda. Public sector regulation and private sector reforms "can reinforce one another," said Armínio Fraga, president of the central bank.

Option 2: Raising Standards at BOVESPA

A second option was to raise corporate governance and transparency standards within the exchange itself and strengthen BOVESPA's own enforcement capability. For example, BOVESPA could move ahead with new regulations that strengthened minority shareholder rights and improved financial disclosure requirements. The risk of imposing new, tougher standards, however, was that existing issuers would resent the new requirements and might decide to migrate to foreign markets, exacerbating BOVESPA's decline. Alternatively, to mitigate this risk, BOVESPA could adopt a code of corporate governance best practices modeled on the IBGC's *Code*. Issuers would be required either to comply with each practice or offer an explanation to shareholders for why they opted not to comply. The London Stock Exchange used this "comply or explain" approach to enforce its Combined Code on Corporate Governance. This more voluntary approach would encourage compliance with these best practices because investors would reward complying companies with higher stock valuations and "punish" those that resisted the new, higher standards with lower stock valuations. But, as one BOVESPA executive explained, this approach also entailed risks:

This system of "comply or explain" is good because it's voluntary. But the problem is [that] the majority of companies don't comply, and investors don't bother to read their explanations. It's an important instrument to induce governance practices, but it's not necessarily efficient. It only works if companies feel compelled to comply by investors who tell them, "Listen, this isn't a proper justification for not complying."^{xiv}

Option 3: Creating a New Listing Segment

A third option, proposed in the BOVESPA-commissioned Mendonça de Barros report, was to create an entirely new segment of the BOVESPA stock exchange with more rigorous corporate governance, disclosure and transparency standards than existed with the traditional exchange. As the report explained, precedent for this approach already existed: Germany, for example, had created the Neuer Markt ("New Market"), a segment of the Frankfurt Stock Exchange launched in 1997. The Neuer Markt model was attractive because of its unique approach to governance standards.

A large number of stock exchanges around the world decided to create "alternative markets" in the 1990s. In France it was the Nouveau Marché, in Italy it was the Novo Mercato.^{xv} The idea behind these alternative listing segments was to make things easier for companies [by making] their listing requirements less demanding, and in this way attract more companies to list. The last of these markets to be created in Europe was the Neuer Markt. But their idea was, "Instead of making lower requirements, let's make *higher* requirements."^{xvi}

By 2000, Neuer Markt already appeared to be a success, with more than 200 IPOs, representing 30 percent of the total number of IPOs in Germany since 1949. If this model were adopted in Brazil, the "Novo Mercado" would mirror the Neuer Markt and provide higher standards of corporate governance, including:

- Only voting shares (one share-one vote).
- Minimum 25 percent free-float.

- Quarterly financial statements reported in accordance with U.S. GAAP or IFRS standards.
- Publication of an annual calendar of board meetings and annual analyst meetings.
- Companies would legally agree that any shareholder disputes would be resolved by an arbitration panel rather than through Germany's judicial system.
 - The possible addition of 100 percent tag-along rights.
 - A requirement that at least 20 percent of the board be comprised of independent directors.

Both new and listed companies could opt to raise capital on the new segment, provided that they agreed to comply with the new corporate governance requirements. The incentive to participate would be the probability of higher stock valuations, which in turn would lower firms' cost of equity capital.

There were numerous advantages of creating an "alternative segment." The new corporate governance and disclosure standards would be voluntary rather than required for existing issuers. This would allow companies less able or willing to change their corporate governance to either remain in the traditional stock exchange or migrate at their own pace.^{xvii} BOVESPA could set much higher standards than were likely to be included in an amended Corporate Law, or those imposed on issuers with Option 2, precisely because BOVESPA would not oblige companies to comply.

As with the other reform options, this approach also entailed risks. Existing issuers might resent the new "better governance and transparency" segment, which would make them look poorly governed and suspiciously opaque in comparison.

To mitigate this concern, one proposal was to create an intermediate listing segment that would require better corporate governance and greater disclosure, but would lack the most stringent requirements of the new "better governance" segment, such as an outright ban on non-voting shares. Companies with the motivation to gradually improve governance could signal their good intentions by migrating to this intermediate segment.

There also was the risk of the unknown. Creating a "good governance" segment had never been tried before in a developing country. What would happen if BOVESPA invested precious amounts of political capital and credibility to launch the new segment, and then no companies chose to list, or investment bankers refused to underwrite securities in the untested market?

The pros and cons of the three approaches are summarized below.

Pros and cons of BOVESPA's reform options

Option	Pros	Cons
Option 1 – Legislative reform	<ul style="list-style-type: none"> • Low risk and cost for BOVESPA • New standards universally apply to all publicly listed firms • Enforcement burden remains with CVM/federal government 	<ul style="list-style-type: none"> • Slow pace of reform • Weakening of standards due to lobbying/compromises • Loss of control over reform process
Option 2 – Raising standards at BOVESPA	<ul style="list-style-type: none"> • BOVESPA has control over pace and extent of reforms and over enforcement • New standards universally apply to all BOVESPA-listed firms • With “comply or explain”, issuers have a market incentive to comply with higher standards 	<ul style="list-style-type: none"> • Existing issuers would resent new stricter standards • Risk of de-listings or issuer migration to international exchanges • Inattentive investors/inefficient market limits effectiveness of “comply or explain” market incentives
Option 3 – Creating a new listing segment	<ul style="list-style-type: none"> • Issuers can migrate/adopt standards at their own pace • BOVESPA can set higher standards than possible in Options 1 and 2 • Listing contracts are legally binding and enforceable • Arbitration panel resolves disputes faster than judiciary • Intermediate segment provides a stepping stone for less flexible issuers 	<ul style="list-style-type: none"> • Cost, time, and political capital involved in establishing a new segment • Risk of unwillingness of market participants to issue or invest in a new segment • Alienates existing issuers that do not migrate by making them look bad in comparison • Allows majority of existing issuers to remain under current low governance standards

Conclusion

Santana and Mifano sat at the CVM offices struggling to decide among their options. Reforms were urgently needed, and, as Santana said, “Given how bad things were, BOVESPA had very little to lose. Our opportunity cost was low. ‘Let’s risk it. Let’s do everything we can.’”

Which of the three approaches, if any, should they recommend to the BOVESPA board? And, whichever approach they recommended, how could they ensure major stakeholder interests were taken into account in order to encourage their support? In particular, how would they sell the idea to existing issuers? How would they overcome the distrust that was rampant among both domestic and foreign investors? How could they structure the reforms to encourage more SMEs to raise equity capital on the exchange? And finally, no matter what they recommended, how could they mobilize the necessary political support?

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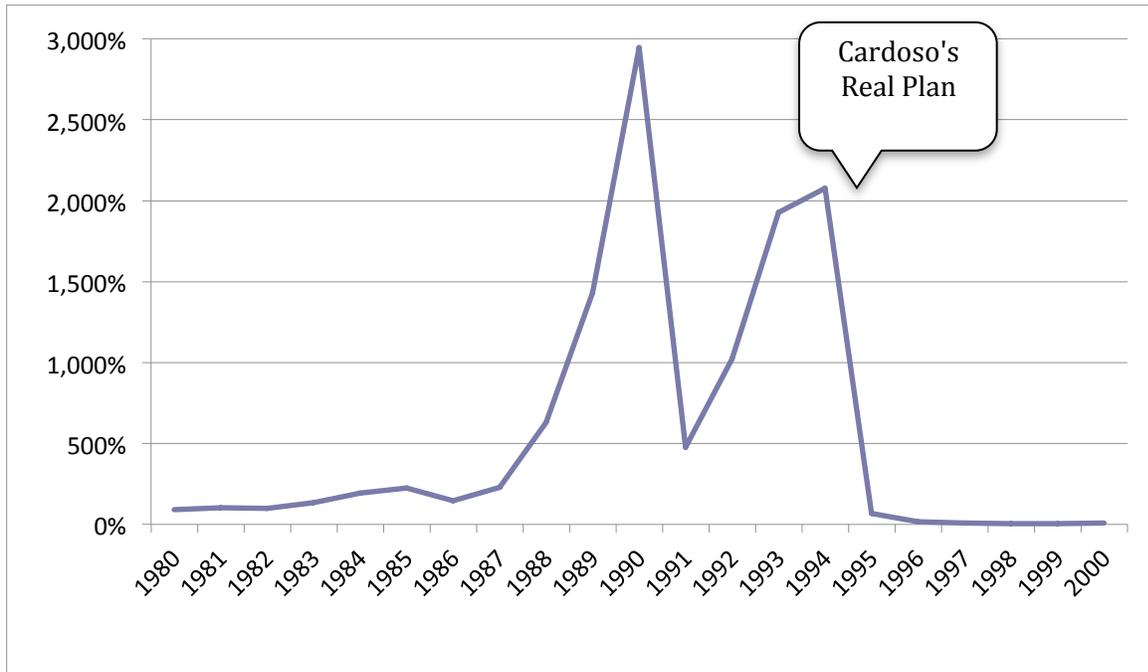
Annexes

Exhibit 1: Glossary of Acronyms and Terms

Acronym/Term	English definition
BM&F	Brazilian Mercantile and Futures Exchange
BNDES	Brazilian Development Bank
BOVESPA	São Paulo Stock Exchange
BVRJ	Rio de Janeiro Stock Exchange
CVM	Securities and Exchange Commission
GAAP	U.S. Generally Accepted Accounting Principles
Grupo de Mercado de Capitais	Capital Markets Working Group
IBCA	Brazilian Institute of Corporate Directors
IBGC	Brazilian Institute of Corporate Governance
IFC	International Finance Corporation (World Bank Group)
IFRS	International Financial Reporting Standards
IGC	Index of Shares with Differentiated Corporate Governance
IPO	Initial Public Offering
NYSE	New York Stock Exchange
OECD	Organisation for Economic Co-Operation and Development
Stock market capitalization (also “market cap”)	Total value of all shares of companies listed on the stock exchange. This is one indicator of the total size of the stock market.
Price-to-earnings ratio (also P/E ratio)	Ratio of a company’s current share price compared to its per-share earnings.
Related-party transactions	Arrangements between two parties who have an existing relationship, which may create conflicts-of-interest.
Share types:	
Common shares	Shares that usually provide the shareholder with voting rights and periodic payments that may be suspended or eliminated if the company performs poorly.
Preferred shares	Shareholder does not have voting rights, but has priority over common stockholders for dividend payments.
Nonvoting shares	Stock that provides the shareholder with no voting rights.
SMEs	Small and medium enterprises
Tag-along rights	Protect minority shareholders in the event that the majority

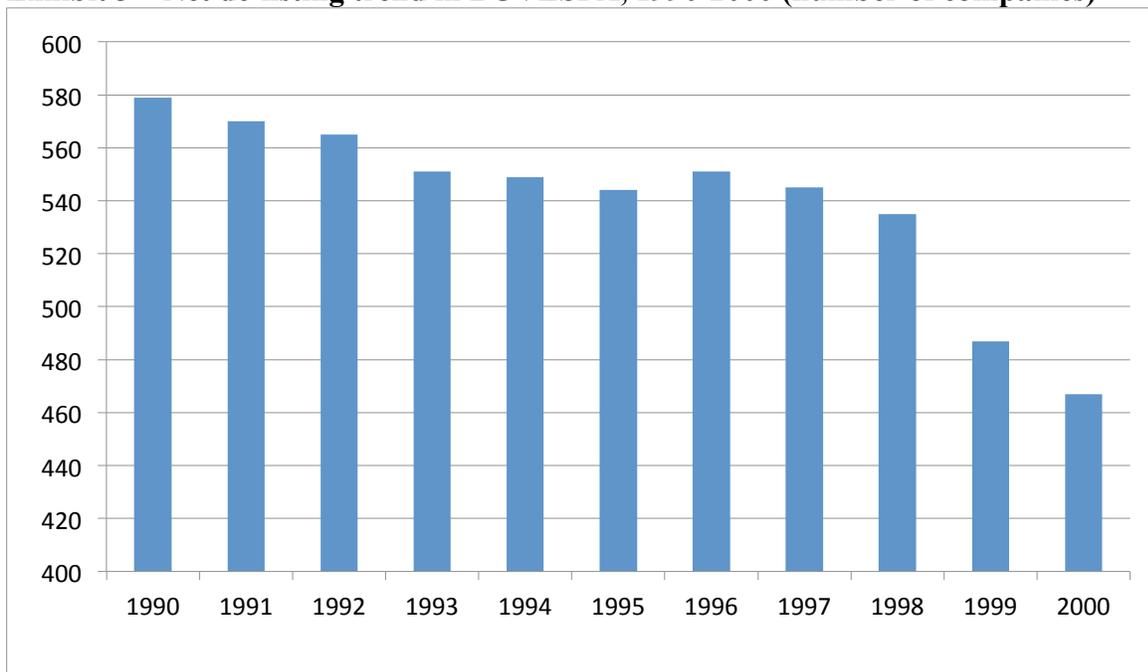
shareholders decide to sell the company to a third party (e.g. privatization). Minority holders have the legal right to sell their shares at the same price and have the same terms as the majority shareholder.

Exhibit 2: Consumer price inflation in Brazil, 1980-2000



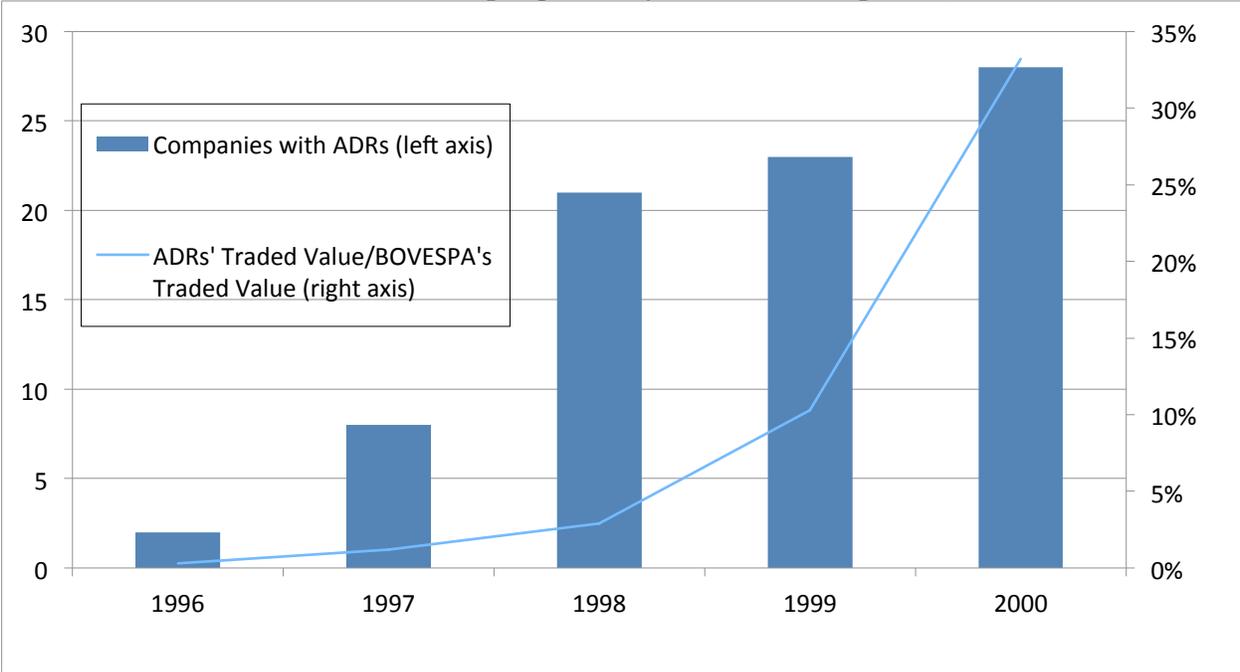
Source: International Monetary Fund (2010).

Exhibit 3 – Net de-listing trend in BOVESPA, 1990-2000 (number of companies)



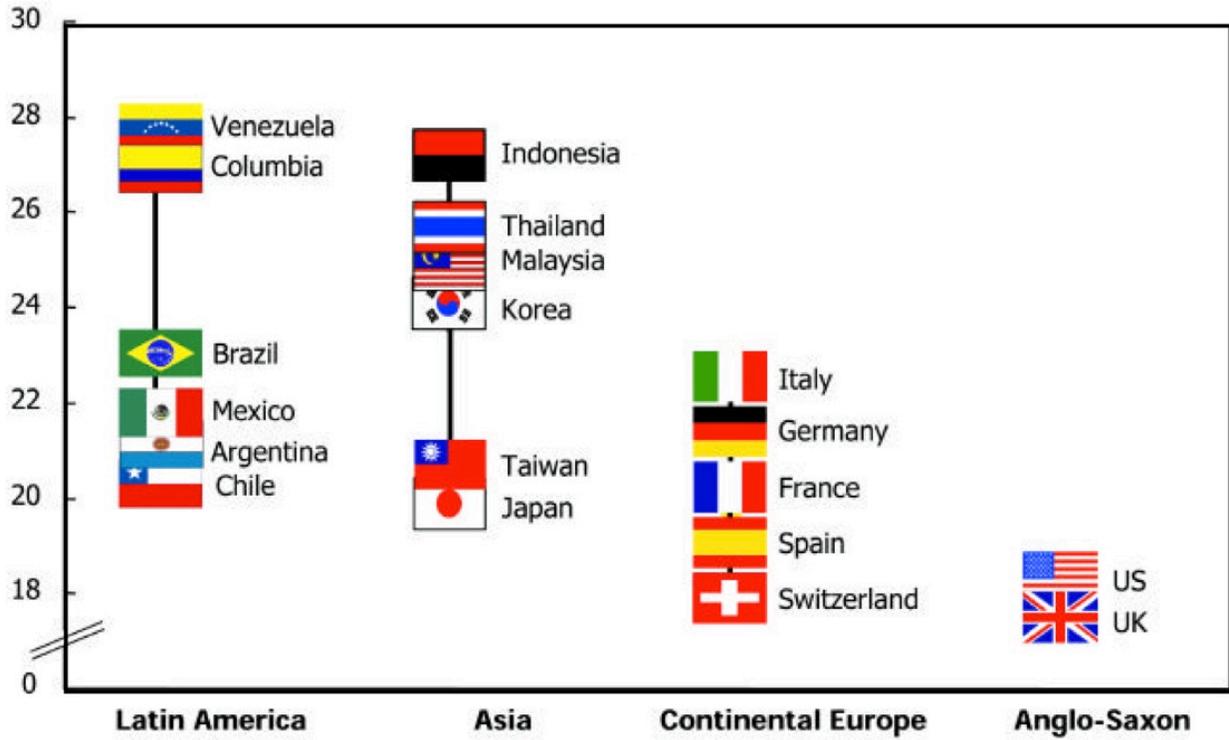
Source: Maria Helena Santana, et al (2008).

Exhibit 4: Trend in the use of ADR programs by Brazilian companies, 1996-2000



Source: Maria Helena Santana, et al (2008).

Exhibit 5 – Average “good governance premium” (percent)
 Average percent premium among those willing to pay a premium.



Source: McKinsey & Company *Investor Opinion Survey* (2000).

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Endnotes

ⁱ Santana (2010).

ⁱⁱ Mifano (2010).

ⁱⁱⁱ Santana (2010).

^{iv} Guerra (2010).

^v Some of these practices were not included in the IBGC's first *Code*, which dealt primarily with the composition of the Board of Directors. However, they were much discussed at the time and ultimately incorporated in subsequent editions published in 2001, 2007, and 2010.

^{vi} Related-party transactions are business deals or arrangements between two parties that are joined by a special relationship prior to the deal. An example would be a contract for a major shareholder's company to perform renovations to a corporation's offices. While the majority of related-party transactions are harmless, the special relationship between the parties involved creates potential conflicts of interest, and could benefit those involved in the transaction at the expense of shareholders.

^{vii} Mendonça de Barros et al. (2000).

^{viii} Gledson de Carvalho (2010).

^{ix} McKinsey & Company (2000).

^x Mifano (2010).

^{xi} Fraga (2010).

^{xii} Osório (2010).

^{xiii} Guerra (2010).

^{xiv} Pellini (2010).

^{xv} Another contemporaneous example of an alternative sub-market is the London Stock Exchange's Alternative Investment Market (AIM), which was launched in 1995.

^{xvi} Gledson de Carvalho (2010).

^{xvii} For example, public service concessionaires risked losing valuable government contracts in the event of changes in ownership structure. Several of Brazil's largest companies were public service concessionaires, meaning they relied on long-term (e.g. 20-year) government contracts for much of their revenue. These valuable contracts would be nullified in the event of a change in ownership structure, including converting non-voting preferred shares into voting shares.