



**Organisation for Economic Co-operation and Development
In Co-Operation with The World Bank Group**

Synthesis Note

**The Latin American Corporate Governance Roundtable
26-28 April, 2000, The São Paulo Stock Exchange,
São Paulo, Brazil**

**Co-hosted by:
The São Paulo Stock Exchange**

**With the support of:
The Brazilian Securities and Exchange Commission
The Brazilian Institute of Corporate Governance (IBGC)
and
The World Bank / OECD Global Corporate Governance Forum**

1. Background and Summary

Within the framework of the Memorandum of Understanding between the OECD and the World Bank Group, the Latin American Corporate Governance Roundtable is organised by the OECD in co-operation with the World Bank, the International Finance Corporation (IFC) and regional partners. The purpose of the Roundtable is to provide a platform for high-level policy dialogue and multilateral exchange of experience among senior policy-makers, regulators, market participants and non-governmental organisations. The Roundtable will use the OECD Principles of Corporate Governance as a conceptual framework for its work and is also expected to formulate a policy agenda for improving corporate governance in the region.

The first meeting of the Latin American Corporate Governance Roundtable was held in Sao Paolo, Brazil, 26-28 April 2000. It was generously co-hosted by the Sao Paulo Stock Exchange with the support of the Brazilian Securities and Exchange Commission and the Brazilian Institute of Corporate Governance (IBGC).

The meeting brought together about 130 public and private sector experts from Argentina, Brazil, Canada, Chile, the Czech Republic, France, Mexico, Peru, United Kingdom, United States and Venezuela. More than half of the participants came from the private sector and included representatives of such key business organisations as FUNDECE from Argentina and ABRASCA from Brazil. There was widespread agreement that the private sector will continue to play an important role in the work of the Roundtable. Among stakeholder organisations participating in the Roundtable were the International Confederation of Free Trade Unions and the Ethos Institute of Brazil.

Also present were the Inter American Development Bank (IADB), the IFC and the World Bank Group, who was represented by Vice-President Jules Muis. The Securities and Exchange Commissions of Argentina, Chile and Brazil were all represented by their respective Chairmen. Also attending the Roundtable were the Chairman of the Sao Paulo Stock Exchange, Mr. Alfredo Rizkallah, the Chairman of the Brazilian Central Bank, Mr. Armíno Fraga and Brazil's chief delegate to the OECD, His Excellency Ambassador Marcos de Azambuja. The OECD delegation was headed by Deputy Secretary-General Seiichi Kondo.

The inclusive approach and high level participation, gave the meeting considerable visibility and made it serve as an effective launch event, which could establishing the format and substantive content of the Roundtable's future work. These decisions were based on an incisive policy debate and a common understanding of the main challenges in the region.

The Roundtable also facilitated various informal meetings. Notably, the Chairman of the OECD/World Bank Private Sector Advisory Group, Mr. Ira Millstein, met with several representatives of the Latin American business community to discuss their contribution to the Roundtable process.

During the concluding session, the Roundtable agreed:

- To develop a White Paper, which in a Latin American context will formulate a policy agenda for improving corporate governance in the region. A first interim report concerning the White Paper will be discussed at the next Roundtable meeting.
- To hold another three meetings over the next thirty months.
- To hold its next meeting in Buenos Aires in March or April 2001. The meeting will be co-hosted by the Securities and Exchange Commission of Argentina.
- That the next Roundtable meeting, in addition to adopting an interim White Paper report, should focus its discussion on shareholder's rights and equitable treatment of shareholders.

In relation to the Roundtable it was also agreed to co-ordinate the work of the Roundtable (primarily the White Paper process) with the recent initiative by the 3rd Meeting of the Western Hemisphere Finance Ministers to assess corporate governance practices in selected economies against the standards set forth in the OECD Principles of Corporate Governance.

4. Main Conclusions

The main purpose of the meeting was to discuss the public policy perspective of corporate governance. As background material, the meeting was provided with a set of empirical overviews of the relevant regulatory framework, and the current ownership and governance structures in the region. The Roundtable also highlighted ongoing reform initiatives and had a first general discussion of the most topical issues of corporate governance. More detailed discussions and analysis of these specific aspects will be pursued in subsequent meetings of the Roundtable.

The Roundtable agreed that good corporate governance is a **public policy** concern, as the private sector has become an increasingly important vehicle for welfare creation. Privatisation and the growth of institutional investors means that countries increasingly rely on private institutions to create job, generate tax income and to furnish the markets with goods and services. Good corporate governance will be crucial for supporting this private sector basis for economic growth and to effectively channel savings to new investments. Corporate governance plays a critical role in the process of building strong domestic capital markets that can serve the investment needs, not only of existing businesses, but also the needs of tomorrow's new enterprises and industries.

An additional public policy concern relates to the internationalisation of financial markets, where good corporate governance is seen as one building block in the construction of a new international financial architecture aiming to diminish the risk of future financial turmoil. A transparent and effectively monitored market environment for international equity flows enhances the stability of these flows and serves as an early warning system for corporate and financial distress.

From the **private sector perspective** participants underlined that good corporate governance is an increasingly important factor if companies are to access external capital at a competitive cost. Investors and corporate representatives also testified that good corporate governance is an important element in building a competitive business as it provides for better strategic thinking and, to the benefit of long-term value, raises confidence among all stakeholders to the corporation. While

improved regulations and better enforcement are important steps in the process of improving corporate governance, particularly in emerging market economies, such initiatives need to be complemented by private sector awareness and active commitment. Examples of such private sector initiatives at company level, industry level and international level were presented and discussed.

The empirical overview of the Latin American Corporate Governance environment focused on present patterns of ownership and control, and the prevailing legal and regulatory framework. The meeting profited from high quality background papers prepared by the World Bank Group, legal experts and academic scholars. The comparative discussion revealed both differences and similarities among the major countries. The most important characteristics that today influence the corporate governance agenda in Latin America include;

- concentrated ownership in individual listed companies
- limited domestic capital markets with insufficient liquidity
- growth of institutional investors, notably pension funds
- the existence of large recently privatised companies
- the extensive use of non-voting preference shares

Together, these characteristics have generated the following key areas of concern in the region:

- the use and treatment of non-voting shares
- the regulatory framework for changes in corporate control
- the role of the pension funds and other institutional investors in corporate governance
- related party transactions through co-investment by listed companies in private ventures held by the controlling shareholders
- the potential use of the special corporate organ variously known as *sindicos*, *comisarios* and *conselhos fiscais* as a more active corporate governance vehicle

The discussion on **shareholder's rights** concluded that minority protection is probably the single issue that has attracted most attention in the emerging Latin American corporate governance debate. One reason is that most companies are dominated by one controlling owner. Another reason is the experiences from several high profile cases of corporate control transactions where the rights of minority owners have been abused due to the lack of clear rules. In addition to minority protection through direct legal provisions it was underlined that the lack of liquidity was a constant threat to real minority protection, since it deprives small shareholders of the ultimate possibility sell their shares. Measures that will help increase liquidity should therefore be seen as a welcome contribution to the protection of minority shareholders.

In order to protect the rights of shareholders, the market regulators have to be given the proper means and structures to catch up with capital market developments and to carry out their work more efficiently.

The market for corporate control can play an important positive role in re-structuring industries and individual companies. But in order to allow for this, procedures need to be clear, transparent and fair.

After hearing about several examples of dubious take-over practices in Latin America the Roundtable had the opportunity to learn about the recent initiative in Chile aiming to set a framework to better regulate corporate tender offers. Up to now, the regulatory deficiencies in Chile has cleared the way for tender offer operations that have been enormously beneficial to the controlling shareholders, who retained the entire control premium at prices substantially above prevailing market levels. In addition, these changes in control occurred without due transparency or sufficient information disclosure to the stock market.

Present reform efforts in this area generally builds on three underlying principles:

- **Transparency:** Information must be adequate, timely and complete in order to allow for a correct assessment of any offer.
- **Clarity in terms of procedures:** The process must be precise and fair. It must include equal prices for every shareholder and inhibit off-bid transactions.
- **Effective oversight:** The market regulator should have the capacity to ensure that all transactions safeguard the rights of all involved parties and the public confidence in the market.

As the issues facing modern companies are becoming more complex the professional demands on **the board of directors** are increasing. Latin American companies are making more use of independent directors and special purpose committees, but the use and understanding of these practices could be further improved. In Argentina for example, independent directors, not representing particular shareholders or being members of the executive management team, represent only 22 percent of board members in listed companies.

In order to improve board practices, several national bodies, including the Brazilian Institute of Corporate Governance and the Mexican Business Co-ordinating Council have taken a proactive role to support the emergence of more professional boards. Initiatives include the issuing of codes of best practices and offering director training programs. Similar initiatives are currently under way also in other countries, including Argentina. The preliminary results of a report to the Roundtable suggests that the quality of board practices is a major factor for investors when assessing the quality of corporate governance in individual companies. It also suggests that investors are ready to pay a non-trivial premium for stocks in companies that they consider meet high corporate governance standards.

The Roundtable fully recognised that the competitiveness and ultimate success of any business corporation is the result of the combined contributions from a range of different constituents, including employees and local communities. In relation to **the role of stakeholders in corporate governance** the Roundtable engaged in discussions on how corporations actively can reach out and build long term relationships with employees, local communities and others affected by their operations. Such relationships can in many instances prove to be a very valuable asset for the corporation and its shareholders. It was also noted that there are certain legal limitations to the ability of corporations to act in any other interest than that of the company and its shareholders, as such activities could be seen as a breach of duty. The employee perspective was underlined by a discussion on the work force's increasingly important role as direct or indirect shareholders. In recent years, trade unions have started to make fuller use of this ability to influence corporate

*The Latin American Corporate Governance Roundtable
São Paulo, Brazil, 26-28 April 2000*

decision-making. It was also pointed out that stakeholders do not necessarily constitute a homogenous group with a common agenda as they may sometimes have conflicting interests.

The last aspect of corporate governance reviewed by the Roundtable was **disclosure and transparency**. The discussion highlighted that good corporate governance requires credible disclosure not only on the financial results, but also on non-financial issues such as ownership structures and ownership arrangements. It was also concluded, that in order to be effective, transparency provisions have to be supported by an institutional infrastructure, which generally consists of four main elements; legally mandated disclosure requirements; good accounting standards; independent auditors, and effective enforcement.

A number of national and international initiatives in the area of disclosure were presented, including the proposed changes in Brazilian Corporate Law. Among other things, these changes would introduce cash flow as basic financial statement, segment information disclosure, consolidation of subsidiaries and pension accounting.

The Roundtable showed great interest in a recent initiative by the International Forum on Accounting Development, which is an exercise driven by the profession and aiming to raise the standards of financial reporting and auditing world-wide. Part of this work will include an analysis of national differences in accounting and auditing practices with a view to assess shortcomings and set priorities for improvement. The intention is to include also Latin American countries in this exercise.