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**Non-listed Companies in Colombia**

By

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For emerging economies, the importance of corporate governance in non-listed companies is clearer than for public companies. In Colombia for example, 96% of the total sales of the entrepreneurial system are made by closely held companies, and only 1.6% of Colombian companies are in public markets.<sup>1</sup> This reflects how important this concept is in contributing to the growth and sustainability of the economy in the country.

The challenges for corporate governance of closely held companies in emerging markets could be summarised as two-fold: 1) the necessity to expand and improve capital sources; and 2) the urgency to strengthen and formalize companies' decision-making processes.<sup>2</sup> In closely held companies, corporate governance is a mechanism to counterbalance the concentration of decision power, to reduce the informality of financial and tax information, and to introduce professionalized criteria for hiring officers of the company to improve its management decisions.

Colombian companies are especially financed by majority shareholders (usually family-based), suppliers and banks. This means that they are generally characterised by short-term debt and restrictions on their growth. Most of the closely held companies in Colombia are reluctant to seek out an external investor or multiple shareholders through the use of a public market as a source of capital, basically due to the lack of knowledge of the public markets and the unwillingness of controlling shareholders to lose their control over the company<sup>3</sup>. The typical structure of ownership in Colombia is characterised by a majority shareholder who would also be the manager of the firm; and minority shareholders with very limited means to redress violation of their rights<sup>4</sup>. For these reasons, one of the biggest obstacles for the development of the capital markets is the understanding of corporate governance within closely held companies. Governance rules and practices are the first step in the pathway to public markets.

In Colombia, the Chambers of Commerce have been focusing on working with boards of directors as the effective way to impact governance in companies. For this purpose, Confecámaras and the 57 Chambers of Commerce are providing training and education regarding the importance of corporate governance for this kind of company. The objective is to professionalise directors and teach them the importance of complying with the board's key responsibilities: working for the long-term interests of the company and controlling and supervising the management.

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<sup>1</sup> Economic facts, Confecámaras 2005.

<sup>2</sup> Article "El gobierno corporativo en las sociedades cerradas y las familiares". Andres Bernal. Claves del Gobierno Corporativo 2005.

<sup>3</sup> Colombia-diagnóstico de la estructura de financiamiento del sector real e identificación de obstáculos que han impedido que estas empresas acudan al mercado de valores. Marzo 2004. Fedesarrollo y Anif.

<sup>4</sup> Leonardo Beltran Comparative Analysis of the Colombian Code Framework of Good Corporate Governance for Small and Medium Enterprises and the general OECD Principles of Corporate Governance. Harvard University and OECD, 2004 (unpublished).

The Colombian Federation of Chambers of Commerce (Confecámaras<sup>5</sup>) is focusing on promoting corporate governance as a tool to improve the country's competitiveness. For this reason it is working with non-listed companies, including small and medium-sized companies, state-owned enterprises and any other kind of entrepreneurial organisation in the country. For Confecámaras, "effective corporate governance practice is a key to improving micro-economic efficiency (i.e. competitiveness), which provides the foundation for access to finance for all firms"<sup>6</sup>.

The objective is to ensure the sustainability and competitiveness of Colombian businesses in today's globalised economy, emphasising the importance of closely held companies for the future of the economy.

This article addresses four key questions on governance of non-listed companies to provide an overview of the situation of corporate governance for non-listed companies in Colombia. The article was prepared for the Latin American Roundtable of Corporate Governance that took place in Buenos Aires, Argentina on 22 and 23 June, 2006.

### **What is the legal framework for non-listed company corporate governance-related requirements in your country?**

The legal framework of corporate governance for non-listed companies in Colombia is contained in the Second Book of the Commercial Code, and the Law 222/95.

The Commercial Code in its second book "de las sociedades comerciales"<sup>7</sup> has most of the rules for non-listed companies. The book begins with general provisions of the companies' basic contracts, including rules for the shareholder general meetings, rights and duties to distribute dividends, necessity of external auditing (revisor fiscal), companies obliged to have boards of directors, and situations for company dissolution and liquidation.

Some rules regarding corporate governance for non-listed companies in Colombia worth underlining here are:

Under the Colombian commercial code, all directors need to be appointed through the mechanism of "cuociente electoral," a quotient electoral system. The mechanism is compulsory for the election of directors in all kind of companies. The system consists of dividing the total number of valid votes by the number of board chairs. Each list proposed and voted by the shareholders will have the right to elect a number of directors proportional to the votes obtained for the list.

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<sup>5</sup> Confecamaras and the Center for International Private Enterprise CIPE have been working in a joint project during the last five years, to introduce the concept of corporate governance within the government and private sector. This project also receives technical assistance and support from the International Finance Corporation – IFC; the Organization for Economic and Cooperation Development – OECD; and the Andean Finance Corporation – CAF.

<sup>6</sup> Eugenio Marulanda, Executive President Confecámaras. Introduction Corporate Governance Code for SME's, 2004

<sup>7</sup> About the Commercial Societies. Colombian Commercial Code

All the companies expressing their ownership through shares are obliged to have boards of directors. [Is this a private, non-listed system of issuing shares? Can you explain better how this system works, and roughly how many companies that are non-listed have shares and therefore are required to have boards?] On the boards, the code only says that it must have a minimum of three directors. Under Colombian commercial law, a simple majority at the shareholder meeting can remove a director, and it is not permitted to establish provisions against this principle in any document.

The following decisions are reserved to shareholders : appointment of directors and other officers; appointment of an external auditor (revisor fiscal); approval of annual reports and financial statements; approval of any amendment to the by-laws, such as mergers and spin-offs; approval of dividend distributions, whether in cash or in stock; and any other action expressly reserved in the by-laws.

Colombia has a special system for external auditing. Under local regulation, the “revisor fiscal” is compulsory for all corporations. This person needs to be a certified public accountant and his/her main responsibilities are: certifying the financial statements; assuring compliance with the company duties and regulations, including tax and financial responsibilities; and preserving shareholders’ interests.

In 1995, the National Congress introduced a reform to the Commercial Code through the Law 222. Under this act, directors’ responsibilities were strengthened. The Congress established many standards for directors, based on the good businessmen standard [can you explain what you mean?], with great emphasis on diligence and care elements.

Moreover, Law 222/1995 eased the requirements for proxy voting, as the only requirements for proxies are (a) they must be written and (b) they must specify the meeting or meetings for which they are given. Proxies with blank spaces are prohibited.

In addition, the law provides for the possibility of distance meetings, and requires that certain decisions be taken only when they were previously included in the agenda (mergers, spin-offs, and transformations among them). Law 222/1995 includes a regime for non-voting shares, sets out the legal framework for the protection of the holders of these shares, including the events in which they will have the right to vote.

Colombia has a Companies Superintendence in charge of supervising and controlling all the non-listed companies of the country. At this time the country is debating what the role of government supervision should be for non-listed companies. [Can you say more about the elements of the debate and different views (or interest group positions) on this subject? Is the government considering reducing regulation or increasing it? Or merging it with other institutions?] The government is analyzing the impact and reasons for having a government office in charge of supervising the conduct and resolving conflicts among managers and directors of closely held companies<sup>9</sup>.

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<sup>8</sup> Law Business Research. Getting the Deal Through – Corporate Governance. Holly Gregory and Ira M. Millstein, 2005

<sup>9</sup> Article: “Debate a función de Supersociedades”. Portafolio Economic Newspaper June, 2006.

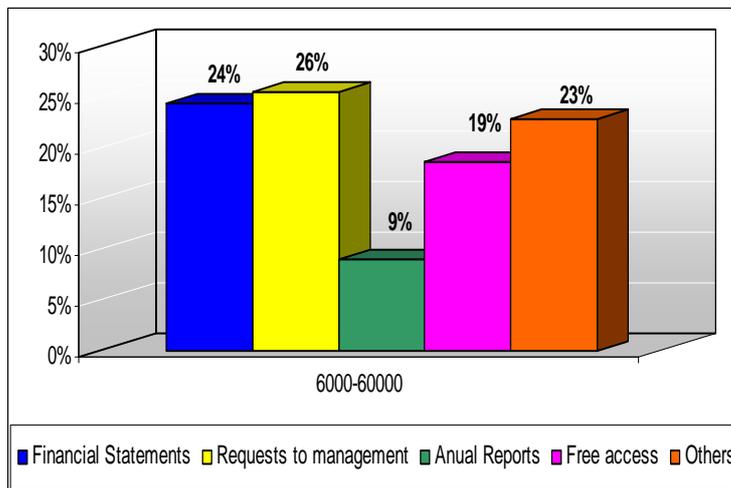
## What are the practices and trends regarding disclosure by non-listed companies?

Colombia, as most Latin American countries, has a reserved entrepreneurial culture; this reduces the level of information about companies' situations, agency conflicts and the development of corporate governance.

Non-listed companies are required to update their financial and some non-financial information annually to the chambers of commerce. This information is published in the business registry: articles of incorporation and by-laws; amendments to the by-laws; structure and composition of the board; legal representative; external auditor; controlling shareholder and annual financial statements.

As an activity of the National Center of Corporate Governance, the Bogota Chamber of Commerce and Confecamaras undertook a corporate governance survey with 250 non-listed companies in 2005. The following graphics could summarize the practices and trends of disclosure in Colombian non-listed companies.

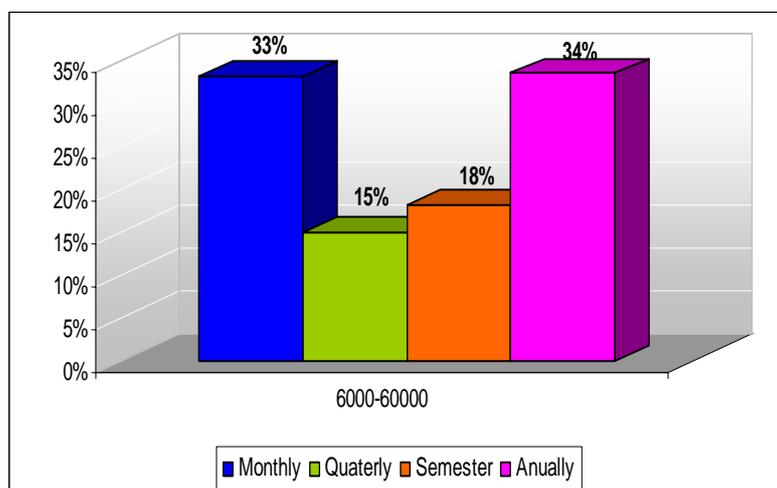
### *How do shareholders access companies' information?*



This graphic shows how the request for information by shareholders is based on informal practices in more than half of the cases. The information channels are the general manager or even free access for the shareholders. Only 33% of companies use only formal mechanisms of financial statements and annual reports to communicate with their shareholders.

Source: Corporate Governance Survey in non listed companies. Bogotá Chamber of Commerce and Confecámaras, 2005

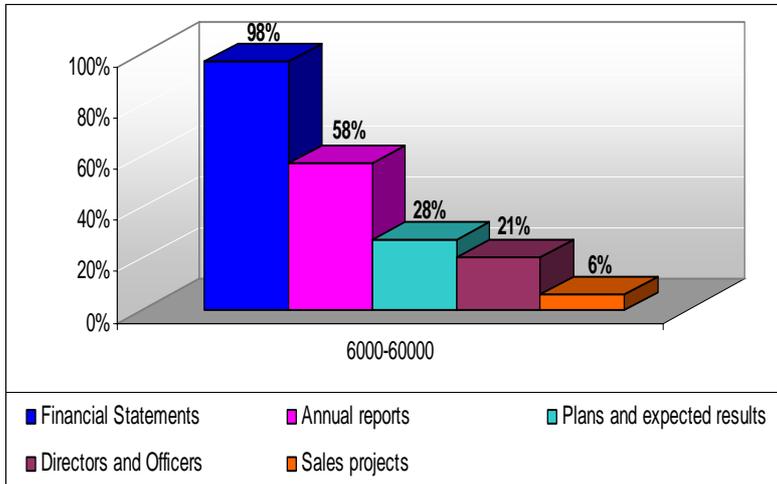
### *How frequent is your communication with shareholders?*



In Colombian closely held companies, especially in SME's, the general shareholder meeting operates as a board of directors. This situation could explain why companies answered the frequency "monthly and quarterly" basis in great proportion.

Source graphic: Corporate Governance Survey in non listed companies. Bogotá Chamber of Commerce and Confecámaras, 2005

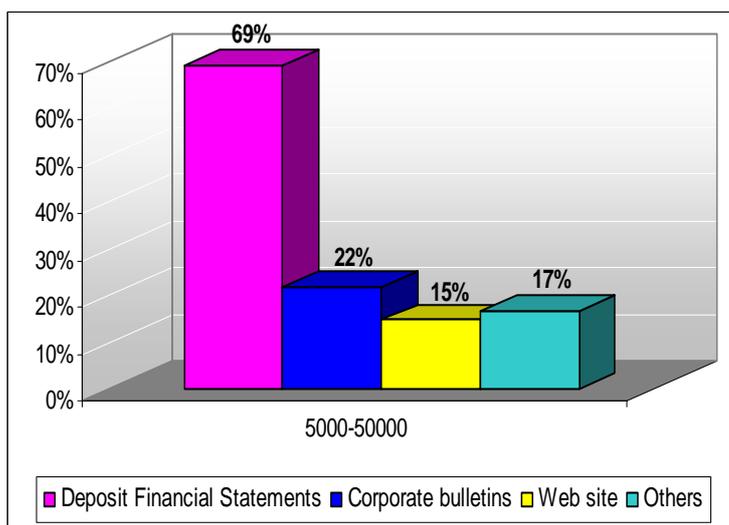
***What is the mechanism to disclose companies' information?***



Colombian companies, by law, must “deposit” their financial statements in the Chambers of Commerce annually. The implementation of web pages for corporate governance purposes is weak in the country for non-listed companies; this situation could increase the cost of accessing information for foreign investors.

Source graphic: Corporate Governance Survey in non listed companies. Bogotá Chamber of Commerce and Confecámaras, 2005

***What kind of information is the company disclosing to shareholders?***



Most non-listed companies in Colombia only communicate financial statements and annual reports that are mandatory by law to their shareholders. An issue to underline is the low quality of reporting about situation?[do you mean material events]? and changes in directors and officers.

Source: Corporate Governance Survey in non listed companies. Bogotá Chamber of Commerce and Confecámaras, 2005

## **What further changes to legal and regulatory requirements may be desirable, and what would be their costs and benefits?**

At this moment, Confecámaras is working with the American Chamber of Commerce (Ambchamb) in a Corporate Governance Committee to produce a document on what the next steps of regulation in corporate governance in Colombia will be [should be?], following the New Capital Markets Bill (Law 964/05) that included a special section on corporate governance called “protection of investors”. In this project, ten law firms are undertaking research on the big obstacles<sup>10</sup> in local regulation to implementing best practices of corporate governance.

Preliminarily, we have found difficulties to incorporate independent directors with the compulsory method of “cuociente electoral,” and the requirement of 100 percent shareholder participation for distance meetings of shareholders.

Time of notices for general ordinary shareholder meetings continues to be 15 workable days, and five calendar days in case of extraordinary meetings. These periods of time have been deemed as relatively short, particularly from the viewpoint of foreign investors. It is still possible to vote on items not included in the agenda, and shareholder approval is not required for the sale of substantial assets.<sup>11</sup>

External Auditors are perceived as another weak element in the Colombian corporate governance system<sup>12</sup>. For this reason, there are a number of proposals to change the supervising method of accountants and to establish clear responsibilities for external auditors.

It is also suggested to change the system to elect the fiscal auditor, which now depends on the decision of the controlling shareholder, who in turn controls the administration. It is necessary to implement actions that preserve and strengthen the fiscal auditor’s independence, so that he/she can fully comply with his/her functions<sup>13</sup>.

The other weakness of Colombian regulation for corporate governance is the lack of adherence to international financial reporting standards for financial information. At this

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<sup>10</sup> The publication will be released on the 26 July, 2006 for Confecamaras and the AmbChamb. The most prestigious corporate law firms are working on the following issues: company disclosure, mechanisms to protect minority shareholders, independent board members, audit committees, duties of board members, boards of directors in closely held companies, corporate governance and arbitration, mechanisms to select board members in closely held companies, and shareholders agreements.

<sup>11</sup> Developing a Progress Report on Implementation of the Latin American White Paper Colombia - OECD country report, 2005

<sup>12</sup> Developing a Progress Report on Implementation of the Latin American White Paper on Corporate Governance in Latin America - Opinion Survey of Corporate Governance in Colombia. This survey consists of interviews with representative national samples of 20 key agent of the market within issuers, investors, legal firms and supervisors. The survey was conducted by Confecamaras and Superintendencia de Valores, 2005.

<sup>13</sup> Ibidem.

time the government is working on a new project of law that could be presented to the National Congress.

At this time, two new national laws are imperative to create a better framework for corporate governance in the country: the incorporation of international financial standards to update the financial reporting system, and the reform to the commercial code to ease the incorporation of best practices.

**How this should be balanced with voluntary efforts to promote better corporate governance of non-listed companies?**

There are many private initiatives in Colombia to promote corporate governance in non-listed companies<sup>14</sup> and this is a good indicator of the importance and awareness of the concept in the country. In Colombia, the private sector has had the initiative and has been very active in the debate on corporate governance. At the same time, the national government has been very receptive to talk about and discuss corporate governance with the private sector.

All the private initiatives have a good dialogue with government, which is fundamental to create regulatory and self-regulatory processes that, in the end, will help to increase the competitiveness of the country.

Regulation must be oriented towards socializing the entrepreneurs about the importance of the issue, showing them that Corporate Governance is good business rather than an imposition.

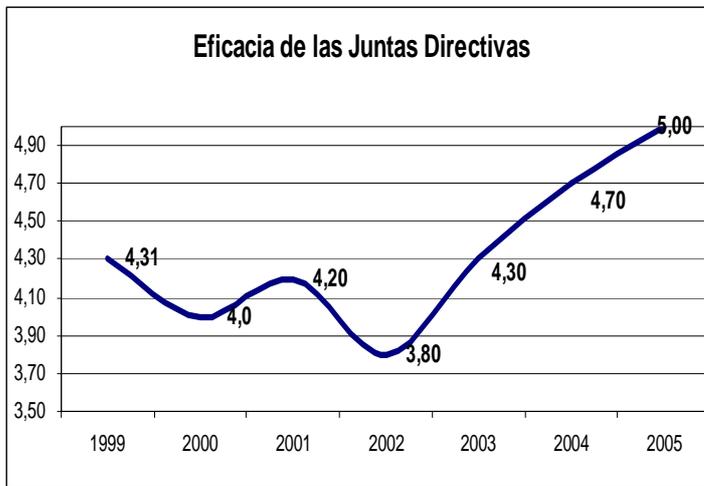
**Conclusions**

Joint work of the government and the private sector in Colombia allowed the country to advance in the consolidation of business confidence. In the latest comparative international studies, such as the *Competitiveness Report* (World Economic Forum) and *Protecting Investors* (World Bank, IFC and Lex Mundi), Colombia appeared to advance significantly in terms of corporate governance and protection of investors.

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<sup>14</sup> The Colombian Stock Exchange through a program sponsored for the Inter American Development Bank (IADB) in a program titled “Colombia Capital” to increase the number of issuers with greater emphasis on corporate governance; the National Federation of Insurance Companies (Fasecolda) structuring a CG code for the industry; Bancolombia as a private bank is working with their family business clients; and Confecámaras and the Chambers of Commerce are establishing a National Center of Corporate Governance to increase awareness and develop tools and literature. The programme is supported by CIPE and co-ordinated by Confecámaras, and is doing activities in Colombia, Ecuador and Venezuela.

### *Board of Directors Effectiveness*



The perception of Colombian boards of directors is increasing in the Global Competitiveness Report. A great part of the work needs to be done with universities in order to train the future businessmen and managers; furthermore, it is fundamental to organize director courses to professionalize boards.

Source: Analysis - Evolution of the indicator of Efficiency of Board of Directors. Competitiveness Report – World Economic Forum

### *Index Protecting Investors*

Protecting Investors				
Country	Extent of disclosure	Extent of director liability	Ease of shareholder suit	Strength of investor protection
Peru	7	5	7	6,3
<b>Colombia</b>	<b>7</b>	<b>1</b>	<b>9</b>	<b>5,7</b>
Chile	8	4	5	5,7
Argentina	7	2	7	5,3
Brazil	5	7	4	5,3
Mexico	6	0	5	3,7

Source: Protecting Investors – Doing Business. A publication of the World Bank, International Finance Corporation and Lex Mundi, 2006

It is imperative to continue working with closely held companies on the importance of corporate governance. A good understanding of cultural concerns and local financial structures is essential in order to introduce a real culture of governance in non-listed companies. Moreover, it is essential to create economic and reputational incentives for non-listed companies and to convince banks, suppliers and insurers of the importance of corporate governance, as a strategy to reduce corporate risk and increase companies' sustainability.

The government needs to present once again the project of law to introduce the obligation to implement International Financial Reporting Standards to facilitate the attraction of foreign investment. On the other hand, the private sector needs to start to discuss how to update the Commercial Code to introduce good corporate governance practices.

Colombia has advanced in corporate governance with a strategy to create awareness of this concept within private and public companies. This good situation requires high responsibility of the agents involved in promoting, supervising and implementing good practices in the country; business associations, universities and government offices need to focus all their efforts to preserve the achieved results and to start to transform them into social and economic benefits.