The 2013 Meeting of the Latin American Corporate Governance Roundtable

Session 4: Breakout Sessions

Corporate Governance Indices: the Benefits and Risks

Corporate Governance Challenges for Company Groups

SME financing and corporate governance implications

Note: Enclosed are one-page background notes with questions for discussion for each of the three breakout sessions (16:30-18:00) scheduled on June 20th. Please refer to these notes to decide in advance which session to attend. Participants will be invited to indicate by a show of hands during the meeting which session they wish to attend before room assignments are decided and announced. Simultaneous interpretation between Spanish and English will *only* be available for the breakout session held in the main meeting room, which will be reserved for the session with the largest number of participants.

Corporate Governance Indices: the Benefits and Risks

Moderator: Heloisa Bedicks, Executive Director, IBGC Brazil

Lead speakers: Pasquale di Benedetta, World Bank, and Andreas Grimminger, Consultant.

Since 2001, eight stock exchanges around the world – including in Brazil, Mexico and Peru within the region -- have launched corporate governance indices (CGIs), sometimes as part of a broader environment, social, and governance (ESG) initiative. Di Benedetta and Grimminger conducted a comprehensive analysis of these indices for an IFC/World Bank study. The study finds that CGIs have had a positive impact, enhancing legal and regulatory frameworks by extending governance criteria to develop objective and measurable benchmarks. It also shows that CGIs present companies with an opportunity to differentiate themselves in the market and, ultimately, offer companies an incentive to adopt better governance practices. Nevertheless, as the process for vetting and evaluation of companies for inclusion in the indices continues to evolve, access to underlying methodologies, disclosure of the ratings and self-assessments of individual companies, and of overall monitoring processes and procedures can still be enhanced.

The following are six key findings of the IFC/World Bank study:

1. Corporate governance indices can be an effective market solution in addressing legal and regulatory gaps, and in enhancing corporate behavior and a company's visibility.

2. Evidence suggests that indices based on binding listing rules allow greater access to capital than those based on corporate governance codes or other scoring mechanisms.

3. Investors recognize the importance of corporate governance in their investment decisions, and the difficulty in gathering related information especially in emerging markets. If set up correctly, CG Indices can help to bridge the information gap.

4. Given the qualitative nature of CGIs, investors need to be careful to properly understand the building blocks and methodology an index is based on as information and expectation asymmetry may pose unforeseen risks.

5. In most CGIs, key challenges for investors remain: access to index information and rating methodology is limited, and company evaluations are rarely made public.

6. Virtually all CGIs have had strong constituent growth. However, most are struggling to beat the benchmark index. This often reflects the overlap of constituent companies and a lack of depth in the capital markets.

Questions for discussion:

- What are regulators/stock exchanges in the region doing or planning to do to incentivize the adoption of good corporate governance practices going beyond law and regulation by listed companies?
- In addition to the risks raised by the study, are there any particular regional issues that would make the introduction of CGIs difficult?
- Is there a danger that investors, and in particular institutional investors, will neglect their due diligence and intervention on CG issues if they think that corporate governance issues/problems will have been taken care of by the index raters/selectors?

Corporate Governance Challenges for Company Groups

Moderator: Luis Enriquez, IFC

Lead speaker: Maria Uriza, Argos, Colombia.

Company groups are commonly structured across the Latin American region. However, governance issues pertaining to conglomerates generally receive relatively minor attention. To address this concern and provide a set of recommended best practices for company groups, a working group of the Latin American Companies Circle has been established. This session will present the issues that the Circle working group is considering, and seek input to the issues from the wider Latin American corporate governance community.

Types of Company Groups:

Company groups may be structured with different types of subsidiaries that may give rise to several different governance issues and requirements (particularly in the specific case of highly-regulated entities).

- Based on ownership interest, a company group could have wholly or partially-owned subsidiaries.
- From a shareholding distribution perspective, partially-owned subsidiaries could be closely or publicly held.
- Finally, based on their scope of activities, subsidiaries could be highly regulated (i.e. financial institutions) or unregulated.

All these different types of subsidiaries could be present within one single conglomerate or even combined in a single subsidiary (such as a partially-owned listed bank). Moreover, the holding company itself could be a listed company.

Questions for discussion:

- What specific governance issues could arise when company groups are structured?
- What corporate governance measures can be taken to ensure coherence between a group's overall business strategy and those of its subsidiaries, whose business interests may in some cases differ? Are there techniques such as through board nomination processes, guidance documents or training of board members to help build a coherent and clear framework for board decision-making among all companies in the group?
- What best practices could be recommended to protect the interests of minority shareholders of holding companies? How would the foregoing differ in the event a minority equity investment is to be made at a subsidiary?
- From a regulatory angle, what policy measures should a regulator adopt with respect to company groups? For instance, how should it regulate related-party transactions among group companies?

SME financing and corporate governance implications

Moderator: Michael Penfold, Director of Public Policy and Competitiveness, CAF

Lead speakers: Erick Lagos, Managing Director, Lafise Investment Management, Fund manager of Caseif and José Alberto Garzón Gaitán, Vice President, Bancóldex

While the OECD Principles of Corporate Governance are primarily aimed at listed companies, non-listed small and medium enterprises (SMEs) are not exempt from applying these recommendations. To be sure, no matter the size or ownership structure of companies, corporate governance has important benefits that go beyond the issue of attracting minority shareholder investment: good corporate governance, including sound management, accounting systems and controls along with improved disclosure, provide an important basis for improved company performance and value, and stakeholder relations on fair and productive terms. On the other hand, bad corporate governance and poor standards are barriers to accessing financial resources.

As commercial banks and private equity funds, more than capital markets, play a key function in providing financial resources to SMEs in the region, they have an important role to play – at least potentially -- in promoting good corporate governance practices. However, each one has a different business model, with specific requirements and priorities. Banks as creditors are required to evaluate the repayment capacity of the client, while private equity funds as minority shareholders may consider their primary focus as increasing the market valuation of companies with a view towards a profitable exit strategy.

In that sense, the goal of this session is to analyze the specific challenges faced by these two SME-financing vehicles in the process of influencing the implementation of effective standards of good corporate governance in SMEs, their particular roles in promoting good corporate governance in SMEs, their priorities and the instruments available.

Questions for discussion:

- Why should banks / private equity funds be interested in assessing the corporate governance of SMEs?
- What should be the role of banks / private equity funds to promote/ influence better corporate governance of SMEs?
- Considering the limited resources of SMEs, what corporate governance issues should be addressed as a priority to improve, from the point of view of banks / private equity funds? e.g. establishment of boards, inclusion of representatives of investor/creditors on the boards, adoption of high accounting standards and disclosure, development of succession planning, etc.
- What instruments are available to influence these approaches?
- How can these institutions collaborate with each other to signal to SMEs that the supply side of financial resources has a common interest in enhancing corporate governance of SMEs?