CEF
Centro para la Estabilidad Financiera
Center for Financial Stability

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Corporate Governance in Argentina[1]

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EXECUTIVE SUMMARY

Corporate Governance (CG) refers to incentive mechanisms developed to operate business firms, with the purpose of protecting the interests, actions, rights, and duties of the various participants having a legitimate interest (stakeholders). In particular, CG purports to minimize conflicts of interest between those responsible for managing companies (senior management and board of directors) who may impair corporate value to the detriment of shareholders and majority shareholders who may obtain benefits at the expense of minority shareholders and creditors. The current huge interest in this topic goes largely beyond academic boundaries due to its clearly documented impact on corporate value. Several studies, covering a great number of countries and also encompassing Argentina in this Policy Note, show that good CG (a) favors company access to the capital market, (b) reduces cost and extends financing terms generally, and (c) enhances company operating performance. At macroeconomic level, good CG encourages stability, as well as financial system development and economic growth. Finally, it should be taken into account that good CG not only involves "direct" company participants (shareholders, management, directors) but also investors and/or bondholders, employees, suppliers, customers, tax authorities and the community at large. Along this line, transparency and disclosure, as well as proper protection of creditors, minority shareholders and other relevant stakeholders have a major social and democratic dimension.

CG Best Practices include an institutional, as well as a contractual, component. The legal and regulatory framework is known as *Institutional CG.* It comprises investor and creditor rights through equitable treatment of all shareholders and requirements for reasonable transparency in corporate structure and internal decision making process. It is crucial to have effective enforcement of such framework. On the other hand, the initiatives and commitments voluntarily adopted by companies, in addition to legal requirements, are known as *Contractual CG*. The positive correlation between contractual CG and company valuation is more robust in emerging markets than in developed markets, even though the latter have a better institutional framework. It is precisely in relatively weaker institutional contexts that contractual commitments undertaken by companies themselves originate a greater benefit for them, even if capital markets may not be developed enough.

As from 2000, and especially after the scandals staged by Enron and other companies in serious CG troubles, there have been dramatic legal and regulatory reforms in many countries. Such reforms have focused on securities market law, whereas legal frameworks have only imposed general guidelines, leaving regulatory details in the hands of regulators. Before that, there was a conspicuous trend toward issuing codes or recommendations by self-regulatory markets themselves or private sector initiatives enhanced with voluntary rule adoption by companies. Evidence relating to the real impact of such Codes of Good Practices and other blatant corporate failure stories have raised doubts about the effectiveness of "self-regulation" approach, and paved the way for enhanced legislative intervention, such as the U.S. Sarbanes-Oxley Act.

In Argentina, institutional CG is often considered to be relatively developed compared with similar countries. In 2001, Executive Order 677 was a first and major step in the adoption of good CG practices for publicly-traded companies. Although the reform was warmly welcomed by the market, evidence shows that there is still much potential for improving institutional CG in Argentina, including not only publicly-traded companies but also privately-held firms and financial institutions. Along this line, one of the critical aspects not only relates to the existence of an appropriate legal, institutional, and regulatory framework but also to an effective enforcement of laws and regulations. For publicly-traded companies, political and economic independence of regulators is vital for good compliance with CG rules. The analysis of comparative evidence shows that, in Argentina, the level of regulator disciplinary activity is very low indeed. As a supplementary -rather than substitute- mechanism of effective enforcement, one should mention institutional investors who, on account of their invested volume and technical skills, have the possibility of imposing active disciplinary sanctions on companies. Anyway, this type of control in our country is not as deep as it is in more developed markets. Something similar happens with other gatekeepers who monitor companies, such as external auditors and risk rating agencies.

For the very first time in Argentina, a thorough study has been performed in relation to the ownership structure and quality CG of publicly-traded non-financial companies. The ownership structure is relatively simple and it clearly ruled by the company's controlling shareholder. Through pyramidal structures and, to a lesser extent, multiple voting shares, voting rights largely exceed equity rights in many companies, rendering conflicts of interest more acute between controlling and minority shareholders. In Argentina, there are no companies with atomized share ownership, and more than half of the business firms have a foreign controlling shareholder. On the other hand, similarly with other good CG aspects where companies strictly and specifically adhere to the provisions established by law, the average number of independent directors is consistent with the minimum regulatory requirement in force.

In fact, the CG indexes prepared by the Center for Financial Stability (CEF) show that the commitment of companies vis-à-vis CG Best Practices is remarkably low. The improvements recorded between 2003 and 2004 result from regulatory amendments (institutional CG), rather than from a voluntary adoption by companies (contractual CG). In turn, institutional investors do not have proper incentives to weigh good CG as a relevant aspect in their portfolio selection policies and, at the same time, they do not perceive that good practices are being conducted by companies.

It is highly interesting to underscore that *econometric and statistical analysis reveals a substantial impact of good CG practices on market yield and company performance.* Such empirical finding should be given more consideration by companies as well as regulators, market participants and general investors who, in many cases, believe that CG is a topic which has little practical significance in our country.

The case of publicly-traded non-financial companies in Argentina unveils certain prejudices regarding the benefits of good CG practices that the evidence produced should contribute to remove. It is certain that corporate incentives to advance in this field, mainly the possibility of launching primary issues in the capital market, are not strong enough in the short term. However, it is necessary to bear in mind that market development shall not occur without a prior CG improvement, understood as medium-and-long-term investment. To avoid this vicious circle, it is essential that National Government, regulators and self-regulatory markets drive such initiative by enforcing certain minimum standards (which in many cases imply neither greater costs nor disorders) for all companies, and creating incentives for voluntary advances with low or even zero fiscal cost. Diagnosis is supplemented with a set of policy recommendations complying with the above-mentioned characteristics, which are summarized in the following table:

Diagnosis	Recommendations
International trend toward legal and/or regulatory reforms enhanced with proper enforcement in order to ensure compliance, and supplemented with initiatives promoting and encouraging contractual CG improvements.	To proceed with the design of uniform and mandatory requirements for all publicly-traded companies and financial institutions, in line with international good practices, yet considering optimal balance between mandatory and voluntary components. To promote the development of contractual CG mechanisms, such as dissemination and adoption of Codes of Good Practices; special listing segments, such as *Novo Mercado* in Brazil; market indexes and good CG ratings; and so on.
Deficit regarding institutional CG (legal requirements) and contractual CG (voluntary practices). Absence of adequate interest and knowledge by companies, investors and regulatory agencies.	To include in the agenda for public and private discussion the topic concerning the importance of improving CG. To encourage private sector initiatives, through companies and business chambers, foundations, universities, and the Government (taking into

	account that, in the latter case, CG improvements would entail major social advantages.)
As regards the legal framework, there is a positive opinion about the principles enshrined by Executive Order 677/01, even though there is leeway for executing improvements.	To design a new legal framework which should not necessarily imply full alignment with the CG standards in the most advanced countries. One of the pending aspects relates to structural issues connected with the organization of capital markets (demutualization), such as direct supervision on market intermediaries and allocation of economic resources and legal certainty to ensure independence of the financial regulator. To include Executive Order 677/01 Core Principles in a Draft Amendment to the Companies Act, which is a highly important topic to be discussed appropriately. The partial adoption of Executive Order 677/01 principles, as established so far, suggests that mere enactment of legal instruments is not enough to cure the deficiencies screened in CG practices.
As regards the regulatory framework, there is inadequate adoption of Executive Order 677/01 by the regulator. Absence of regulation on aspects included in the legal standard or unspecified regulation, granting discretion to companies as to the degree of compliance with rules (e.g., extended annual report.) On the companies' side, there is formal compliance, with scarce material and qualitative information beyond minimum information required to avoid disciplinary sanctions by the regulator; level of transparency and disclosure being unsatisfactory.	To require more detailed regulation on disclosure requirements to be met by companies in order to reduce discretion and diffusion when material information is disclosed. To promote issues which imply low compliance cost for companies and would have a high impact on minority shareholder protection, as well as information on the structure and procedures relevant to the board and management, past and future dividend policy, board and management compensation policy (specifying adopted criteria) and full ownership structure of companies.
There are no initiatives to improve CG by self-regulatory markets, the absence of changes in listing requirements being conclusive evidence in this domain, if compared with other securities markets worldwide.	To consider the creation of a special listing segment for companies choosing to adopt CG Best Practices. This action should be supplemented with regulations which would provide incentives to institutional investors so that they may invest in companies listed in such special listing segment. Markets should promote and encourage best practices among companies.
Empirical analysis shows evidence of the absence of independent and effective boards, a key component in recent reforms and CG Best Practices recommendations. Although Executive Order 677/01 improvements have helped upgrade board functioning (e.g., introduction of an "independent director"; modulation of director accountability; mandatory formation of an audit committee; etc.), effective functioning and real independence are aspects pertaining to contractual CG and specific corporate practices.	From the institutional CG viewpoint, to improve the manager accountability regime in order to align it with the purpose of creating value, bearing in mind the supervisory role played by the boards and minimizing joint and several liability when there are special committees (horizontal competency allocation) and/or special empowerment is given to a delegate director or management (vertical competency allocation). From the contractual CG viewpoint, it is essential to foster a "culture of effective boards", by promoting codes or principles of good governance, as well as appropriate training and professional skills.
Effective enforcement of laws and regulations is	To procure undertaking measures to provide the

another aspect showing remarkable weakness. Regulators have poor available human and financial resources, as well as little independence from the political power. In addition, no priority has been given to strengthening CG. Enhanced care should be used in the effective enforcement of some CG regulations currently in vigor. Arbitration procedures are rarely conducted in self-regulatory markets. No active role is played by institutional investors and banking institutions, as well as gatekeepers.	regulatory body with independence and adequate resources to monitor and, if necessary, exercise disciplinary powers. This would additionally require performing a review of capital market self-regulation procedures in line with IOSCO International Standards. To emphasize specific enforcement of such rules which imply low cost for companies but have a strong impact on the marketplace. Likewise, to encourage the conduct of arbitration procedures. In order to promote an active role by financial institutions, good CG thereof is a prerequisite. Yet, an active role on their part may require some regulatory changes. A more active role by gatekeepers may require the adoption of auditing and accounting standards closer to the best practices. The adoption of ethical standards by practitioners should be underpinned by proper regulatory incentives.
Institutional investors, rating agencies and financial institutions perceive that companies are reluctant to conduct good CG practices and, at the same time, there are no proper incentives for them to weigh good CG as a relevant aspect in their portfolio selection policies.	Institutional investors should assume a more active role to demand good CG, more deeply interacting with companies and the regulator alike. In the case of pension funds (AFJPs), changes should be made in the regulations governing fees, investment policies and participation such fund managers as minority shareholders in business firms. The latter aspect should include insurance companies and mutual funds. The creation of *premium* stock and bond market segments would contribute to generate a proper incentive.
Institutional investors appreciate good CG when they make their investment decisions and, at the same time, assume an active role within companies.	Both the regulator and market participants should weigh the need for adapting themselves to minimum CG standards, so as to ensure a more friendly access to financing by international institutional investors. Greater market participation by the latter would create significant, positive externalities for the development of financial services.

1. Motivation

1.1. Compared with other countries in the region and emerging markets, Argentina's capital market records a low level of development. This becomes evident in the low level of primary and secondary issues by companies, as well as in the low level of capitalization, trade volume and number of listed companies[2]. A deep capital market is a prerequisite to ensure the strengthening of long-term investment in a context of limited access to foreign savings and institutional investors and banking institutions seriously affected by the aftermath of the financial crisis and default debt occurred in 2002.

1.2. The institutional aspects relating to the legal and regulatory framework, legal certainty, transparency and protection of creditor and minority shareholder rights are included in the reasons usually put forward to account for this relative under-development. The strengthening of such institutions would allow restoring trust in the capital market as a mechanism to allocate savings. Empirical evidence shows that a legal framework which fosters transparency and defines clear-cut accountability rules that may be applicable favors capital market expansion. In particular, one of the aspects that has been addressed more thoroughly on the international front has been CG for issuers.

1.3. CG refers to incentive mechanisms developed to operate business firms, with the purpose of protecting the interests, actions, rights, and duties of various participants having a legitimate corporate interest or stakeholders. The normal operation of any business may give rise to two types of conflict of interest with adverse consequences on its smooth day-to-day management. On the one hand, managers in charge of dealing with the daily affairs of the firm may take advantage of their privileged position within the company to obtain personal benefits at the expense of the shareholder universe. On the other hand, majority shareholders may abuse their power on the firm to obtain benefits at the expense of minority shareholders, who typically fail to have information and resources available to be protected from such abusive action. As one may foresee, these sources of expropriation of shareholder rights affect the conditions under which investors will offer funding to companies. The best CG practices include a legal and regulatory framework which may properly address investor rights by promoting equitable treatment, encouraging and demanding transparency in the decision making process and, in turn, assuring effective enforcement. Along these lines, the set of common rules concerning good CG practices determined by the legal system and the institutions inherent to each country is known as *institutional CG*. For their part, private-sector initiatives and efforts -especially, commitments undertaken by companies on a voluntary basis- are referred to as *contractual CG.* Thus, it does not only involve "direct" participants in the business firm (shareholders, managers, directors), but also investors or bondholders, employees, suppliers, customers, tax authorities and the community at large.

1.4. Empirical evidence on the international front shows that improvements at institutional CG level have a positive impact on the development of the capital market and, through the latter, on economic growth[3]. On the other hand, the correlation between contractual governance and shareholder value or other return on investment indicators is stronger in emerging markets than it is in developed markets. In our country, Executive Order 677/01 was a first and significant step forward in the adoption of some of the international transparency and investor protection best practices, which established a new legal CG framework for publicly-traded companies. One should expect that effective enforcement of the requirements laid down by such executive order may enable to create a minimum CG standard

[2] See Table 3 on page 33.

[3] Claessens, S. (2003) identifies five channels through which empirical evidence shows that CG improvements at country level - and even at sector and firm level- affect growth, employment, poverty and general welfare: (a) greater access to foreign financing by companies; (b) lower capital cost and higher corporate value; (c) better performance as a result of better resource allocation; (d) potential positive CG impact on financial crisis reduction; and, finally, (e) better relationship between the different agents having a legitimate interest in business firms, which could entail improvements in labor and social relations, as well as in other aspects such as environmental protection.

consistently with international best practices. However, there are several aspects associated with regulation, execution, and enforcement in which there is substantial leeway for CG strengthening. On the other hand, the emphasis laid on improving CG within business firms themselves, beyond the institutional standard, is one of the essential aspects for the appropriate development of the local capital market and the access to banking and non-banking financing. Historically, publicly-traded firms have shown minimum CG standards. Despite this fact, over the last years some increasingly important factors such as development of institutional investors, privatization of public utilities and the possibility of having access to international capital markets, together with a growing significance of foreign capital on the local market, have stimulated improvements in the CG standards of some domestic firms. Nevertheless, evidence under study relating to Argentina shows that significant improvements are required in both fields, institutional and contractual CG, if one purports to facilitate access to corporate financing, as well as to encourage development of a deep and broad capital market.

1.5. Considering the importance of CG for the development of financial services, the CEF has included in the core topics of its agenda the study, the analysis and follow-up of CG level within business firms. The short-term goals of this task includes the following: (i) to promote the use of mechanisms to exercise control and discipline over the firm by investors; (ii) to raise greater awareness at business firm, as well as investor, level on the private and social benefits which derive from strengthening CG (both institutional and contractual); and (iii) to stimulate various market participants (investors, shareholders, directors, managers and other stakeholders or participants with a legitimate interest in the company) so that they may improve CG practices.

1.6. A key part of the job associated with monitoring good CG practices consists in designing, constructing, executing and following up CG quantitative measures. Within the CEF working agenda, follow up efforts have been performed via three CG indexes or measures. First, a Transparency and Disclosure Index (TDI) based on public information (provided by different sources) about each firm, thereby showing transparency and disclosure standards that are the key components of good CG. Secondly, a survey directed to non-financial business firms with information relating to their CG practices, business ethics, risk management and market relations, which is shown by the CG Survey Index (CGSI). Thirdly, a survey directed to institutional investors and active capital market participants on CG within business firm, which is reflected by the Institutional Investor Survey Index (IISI). The TDI was measured in November 2003 for the first time, whereas the second measurement was performed in September 2004. Meanwhile, in the second six-month period of 2004, we conducted the first study of the company survey and also carried out the first institutional investor survey. The combination of the three above-mentioned indexes is the first estimate of CG level for publicly-traded companies Argentina. The analysis and disclosure of this type of indicators will allow monitoring overtime the CG status in Argentina[4].

1.7. Along such lines, this Policy Note makes a contribution to the discussion on the application of CG good practices to companies in our country via the analysis of the legal and regulatory framework which shapes institutional CG, as well as the application of CG international standards at business firm level (contractual CG). Section 2 contains a brief summary of specific literature, best practices and international evidence concerning such matter. Section 3 includes an analysis of regulatory trends in the international arena. Section 4 comprises a thorough study of legal and regulatory issues, considering the peculiar features which characterize our country. Section 5 deals with the application of CG enforcement rules in Argentina. Section 6 covers a quantitative study of the stylized facts which characterize CG within

[4] This Note analyzes CG indexes without disclosing the identity of each individual firm. It should be taken into account that the publication of an index based on publicly disclosed information with similar characteristics to the ITD in Canada [ROB Rating System Index published by Globe and Mail Report on Business (2002)] generated a positive reaction on the market value of those firms having better CG structure [Foerster, S y Brian, H (2004)]. This outcome not only shows the potential impact of disclosing a CG ranking but also certain market inefficiency, while it underscores difficulties associated with the accurate valuation of good CG within companies.

publicly-traded non-financial companies in Argentina, thereby presenting the outcome of the CEF CG indexes and assessing the impact of good CG on the performance of non-financial business firms and their return on the market. Section 7 takes into account the diagnostic elements which arise from considering legal aspects, stylized facts, and scenarios evaluated in the previous sections. Lastly, Section 8 introduces a series of policy recommendations geared to improve those aspects associated with quality CG both at institutional and business firm level.

2. Conceptual Framework and Key Determinants of Good Corporate Governance

Corporate Governance (CG)

2.1. There are several definitions of CG for business firms, which are more or less comprehensive as regards their scope. Thus, CG is defined as the ways in which the different suppliers of finance to corporations assure themselves of getting an adequate return on their investments[5]. This definition summarizes the main agency problem relating to the uncertain recovery of the funds invested in any company, regardless of the legal institute or the instrument used. Some definitions are broader[6], including all the institutions which determine how corporate residual profit shall be distributed among the various agents who participated in its creation[7], and even considering that "CG is about promoting fairness, transparency and corporate responsibility"[8]. Of all the foregoing, the most commonly accepted definition corresponds to the OECD: "Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance in relation thereto". For its part, Apreda (2003) stresses the need to consider a broad semantics of governance, applicable beyond merely financial aspects as well as having a scope and being useful for other disciplines, which may take into account functions that are expected to be an integral part of the task of governing organizations or systems in a broad sense[9]. This functional definition considers all the aspects which shape the semantics of CG, including the institutional dimension (according to the Institutional Economics mainstream), a particularly suitable approach for developing countries.

2.2. The different ownership structures influence corporate governance. Ownership models present scenarios with conflicts of interest between the various stakeholders who have a dissimilar approach vis-à-vis changes occurring in corporate ownership structure, governance control and risk inherent to investments in the business firm[10]. Literature principally considers two conflicts of interest within a company. On the one hand, conflicts arising from the model of dispersed capital between management and shareholders and, on the other hand, conflicts deriving from the model of concentrated capital between majority (controlling) shareholders and minority shareholders and creditors. In both cases, conflict relates to the presence of an information gap between agents controlling or managing the firm and agents who fail to participate directly in the firm's decision making process[11]. Privately maximizing benefits by information asymmetry-favored groups may be conducive to poor allocation of resources to the detriment of less informed groups.

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[5] Shleifer, A., and Vishny R. (1997)

[6] Zingales, L. (1997). Caprio, G. and Levine, R. (2002)

[7] Defined by Urtiaga, M. (2003)

[8] Wolfensohn, J. (1999)

[9] Apreda, R. (2003) The CG functional definition refers to governance of organizations (including State-owned enterprises) regarding aspects such as their ownership structure; their legal nature, bylaws and codes of good practices; composition of the board and allocation of decision making rights; directors' fiduciary duties to company owners; investor ownership rights and restrictive covenants; conflict of interest between directors, creditors, owners and other stakeholders; managers' performance and incentives; rent seeking and soft budget; production and disclosure of information to markets, regulators and other stakeholders; proper accountability toward regulators, stakeholders and investors; private, public and global gatekeepers; institutional restrictions, both national and international, including the Judiciary, custom and usage, regulations and enforcement.

[10] Villegas, M and Villegas C.G. (2001).

[11] Although a large number of mechanisms have been developed so that shareholders may influence decisions made by managers and/or minority shareholders may defend their rights vis-à-vis majority and controlling shareholders, even under the best possible institutional or contractual arrangement, insiders shall have more information than outsiders, and the analysis of CG practices shall always focus on creating mechanisms which would allow to minimize such information asymmetry. See Weinberg, J. (2003)

2.3. In the conflict between managers and shareholders, so-called agency problems (known as such because managers act as agents or employees of shareholders) arise from the difficulties faced by the latter to monitor efforts and control allocation of resources performed by managers. In the presence of broad atomized share ownership, monitoring costs for each shareholder become increasingly high, thereby discouraging the execution of regular controls and enabling managers and directors to allocate resources to non-productive expenses and/or appropriation of pecuniary or non-pecuniary benefits at the expense of income or corporate value itself.

2.4. A possible solution to this agency problem is to have concentrated ownership structure. Agents holding a significant proportion of equity have greater incentives to procure information with a view to monitoring management in terms of their efforts and resource allocation. Indeed, it is possible for majority shareholders to designate board (of directors) representatives and enforce their voting rights. However, concentrated ownership creates the second agency problem mentioned above, that is to say, conflicts arising between majority (controlling) shareholders and minority shareholders and creditors. In this case, the former may use control to deviate funds or allocate resources on a substandard basis. For instance, they may announce special dividends or act abusively in their trade relations with other companies for their own benefit. Generally, majority shareholders have incentives to exercise their power to the detriment of corporate value and, therefore, against minority shareholders. Reducing the latter conflict requires that the private benefits of control be self-limited, which imposes a loss on controlling shareholders that should certainly be offset by benefits in terms of higher earnings (as a result of better resource allocation and lower financing cost) and, therefore, greater dividends.

Good CG and Its Impact on Corporate Value

2.5. Financial literature has shown that there is a strong, positive correlation between the legal system quality to protect creditors and minority shareholders –institutional CG[12]- and: (i) capital market liquidity and depth; (ii) atomized share ownership; and (iii) firm valuation[13]. Later on, evidence shall be produced on the link between CG (both institutional and contractual) and performance of publicly-traded non-financial companies in Argentina.

2.6. Available surveys on CG and firm valuation in developed countries generally show that good corporate governance rules or standards accepted on a voluntary basis create a positive impact on corporate value and capital cost. For instance, Gompers, Ishii and Metrick (2003) found that well-governed firms performed better and recorded higher valuation on the market[14], using a comprehensive sample of firms in the U.S.A.[15]. Similar findings derive from a study[16] conducted for European corporations, in which such firms are ranked consistently with a CG quality index (prepared by Deminor on the basis of four groups of subjects) and the investment portfolio return is compared between well-governed and poorly-governed companies, the return spread between the former and the latter portfolio being 2.97% per annum. On the other hand, using a sample of 207 firms in Canada, Foerster and Huen[17] (2004) showed

[12] In order to determine the institutional CG quality ratio, the most appropriate method consists in examining (i) substantive rules on minority shareholder protection and the institutional system's effectiveness to enforce such rules; and (ii) multiplying the results -scorings- obtained from examining each of both items. The simplified approach to measure the first item is based on constructing an index in accordance with company laws governing protection of shareholder rights. See La Porta, R., López de Silanes, F., Shleifer,A. and Vishny, R. (2001). In order to measure the second item, it is used a rule of law index prepared by International Country Risk Guide.
[13] See Paz-Ares, C. (2003).
[14] Measured through *Tobin´s Q* , as adjusted for the mean Q of the relevant sector.
[15] The authors construct a CG Index based on 24 parameters relevant to five CG aspects. The study deals with the correlations between such ranking and several performance variables, and the results show that investing in well-governed firms yields higher earnings.
[16] Bauer, R. and Guenster R. (2003).
[17] Foerster, S. and Huen, B. (2004).

that companies with better CG (the top quintile in terms of ROB[18] Index) obtain a return which is higher than the average annual 8.8% yield in the long term, controlling for market, size and risk return factors.

2.7. Research built up over recent years show that the correlation between contractual CG and firm valuation or other return on investment indicators is stronger in emerging markets than it is in developed markets. In this regard, see Black (2001). These findings seem to challenge the argument that firms in emerging markets do not have incentives to create CG structures which restrain their freedom of action and entail no specific benefits for them, especially whenever capital market development is unsatisfactory.

2.8. The investment firm Credit Lyonnais Securities Asia (CLSA) has prepared CG indexes in the emerging market area. In 2001 they prepared a report[19] based on a survey including 57 variables[20]. The analysis performed shows that there is a close correlation between CG ratings allocated to each firm ranked in the list and financial ratios, listed company performance and firm valuation. For their part, Kappler and Love (2001), after purging the CLSA index and analyzing its relationship to valuation statistical data and institutional CG quality indicators in several countries, underscore that, on the one hand, there is a positive correlation between CG ratings and firm valuation and, on the other hand, the correlation between the level of good CG and firm valuation is stronger in countries with lower institutional CG. Other papers show that good CG reduces the cost of capital, the size of this impact being more dramatic in countries which suffered financial crisis and would possibly have weaker CG systems.

2.9. Domestic market evidence of "value creation" associated with contractual CG improvements has grown on an equal footing with the studies including international data summarized before. One of those papers was written by Black, Jang and Kim (2003) for the Korean economy, based on a questionnaire addressed by the Korean Stock Exchange to all listed companies on CG practices and transparency attitudes. The survey concludes that an index improvement positively affects the market price/book value ratio and the so-called *Tobin's Q* (both measures reflect how the market perceives the future firm growth). Using slightly different approaches, other domestic studies for Russia and Germany produce similar findings on CG importance[21].

2.10. Finally, it should be noted that good CG constitutes a major phenomenon not only for publicly-traded firms –which are the most thoroughly analyzed in this paper- but also for companies that are not listed on the exchange. A particularly important element for financial stability and growth is CG within financial institutions, which are gradually beginning to be examined from this perspective[22]. As far as financial institutions manage themselves within a sound CG environment, they will face lower capital raising costs, be able to generate better allocation of resources and risks, and enhance their capacity to monitor CG within the financing firms[23]. On the other hand, CG is also highly important in the case of family businesses[24], as well as small and mid-sized enterprises (SMEs) [25].

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[18] ROB Rating System Index published by Globe and Mail Report on Business (2002).
[19] Gill (2001).
[20] Grouped in seven large components (senior management discipline, transparency, independence, effective board, accountability of board members and directors, shareholder rights and equitable treatment, and corporate responsibility). Each subject group is allocated 15 scores, except for the last group which is scored 10.
[21] Black, (2001) for Russia and Dobretz et al. (2003) for Germany.
[22] Witherel, B. (2003).
[23] Caprio, G., Laeven, L. and Levine, R. (2004).
[24] Cadbury, A. (2000) and Morck, R. (2004).
[25] The CEF is currently preparing a CG Index for financial institutions which shall be analyzed in a forthcoming Policy Note. In addition, the research agenda includes the development of a Code of Good CG Practices for Family Businesses.

CG Models

2.11. Despite the growing interest in CG-related aspects at international level and consensus on the need to somehow regulate the fundamental aspects of governance practices, there are significant issues open to discussion. On the world front, one may distinguish two corporate governance models: the Anglo-Saxon model[26] and the Continental European model[27]. The characteristics of both models, the reasons for their existence (emergence and development), their possible impact on firm performance and competitiveness, as well as the potential convergence of the two models in a global context, are issues which arouse discussion in specialized literature[28].

Table 1 – Comparative Models

	Market-based Model	Relation-based Model
1.- Ownership Structure		
Concentration Level	LOW	HIGH
Equity/Voting Ratio (cross interests, pyramiding, multiple voting, etc.)	USUAL	UNUSUAL
2.- Markets		
Capital	LIQUID	ILLIQUID
Corporate Control	ACTIVE	INACTIVE
3.- Law		
Company	NON-BINDING (Contractual)	BINDING (Institutional)
Securities Market	STRINGENT	LESS STRINGENT
Legal Family	ANGLO-SAXON	CONTINENTAL
Investor Protection a nd Enforcement	HIGH	MEDIUM/LOW
4.- Other Aspects		
Company Purpose	CREATE SHAREHOLDER VALUE	FIRM INTEREST
Institutional Investor Activism	HIGH	LOW
5.- Corporate Governance Costs		
From Agency Problems between Management and Shareholders	HIGH	LOW
From Ownership Problems between Controlling and Minority Shareholders	HIGH	LOW

Source: Berndt, M. (2000)

2.12. Dispersed or concentrated ownership structure and the type of dominant financing which oppositely characterize both models, Anglo-Saxon and Continental European respectively, are closely related to the pursuit of a solution to the conflicts of interest described above. Thus, in the "relation-based model", concentrated financing (through concentrated ownership, as it occurs in Europe, or related ownership with large banks, as it happens in Japan and Germany) creates incentives to exercise proper control over directors or insiders, where minority shareholders play a marginal role[29]. Capital markets in

[26] Referred to as "market-based model", meaning that firms adapt themselves to market needs in a context of broad atomized share ownership, a developed and efficient capital market, and a highly active "corporate control market" where takeovers, restructurings and mergers are an integral part of the corporate scenario.

[27] The "relation-based model" is the corporate model currently prevailing in Europe, Japan, Latin-America and, generally, in the rest of the countries outside of the Anglo-Saxon world. This model is based on the assumption that companies build sound relations with certain controlling shareholders (in some cases, control being in the hands of banks and/or holding companies or financial conglomerates), financing is dependent on banks rather than on the capital market and the corporate control market is virtually absent from the scene.

[28] Urtiaga, M. (2003). For some authors like Dolar and Meh (2002), both models may be regarded as supplementary, since genuine discussion simply refers to determining which are the rules that ensure proper performance of intermediaries and markets, rather than which is the best corporate governance model. For more recent literature on CG models under discussion, see Macey, J. (1998), where it is held that the market-based model assures superiority in the long term due to the presence of an active corporate control market. For more favorable views on the relation-based model in connection with production systems, see Wilson, R. and Roe, M. (1993).

[29] For instance, the paper by La Porta R., F. López de Silanes, A. Shleifer and Vishny, R. (1998) shows that in the countries of the region (comprising Argentina, Brazil, Chile, Colombia, Mexico and Peru) ownership interests of the three major non-financial

countries where this model prevails are generally underdeveloped and financing is largely provided by banks.

2.13. On the other hand, the Anglo-Saxon model is characterized by more dispersed ownership and financing (such is the case of the U.S.A. and the U.K.) and a more dynamic capital market. In this case, each investor is too small to exercise close control on directors or insiders, but public listing acts as an easy-to-access disciplining mechanism for every investor. In the presence of information asymmetries, reducing conflicts of interest largely rests on material information transparency, adequate market liquidity and appropriate shareholder rights protection[30].

2.14. In the face of growing financial globalization, it is worth considering whether one model may prevail over the other and whether there will be convergence between both models in the future. There is no conclusive answer to this issue. On the one hand, the model prevailing in any country is the spontaneous outcome of domestic institutional conditions and the initial ownership structure of financial and non-financial firms[31]. However, even though the process may be relatively slow, such conditions are not necessarily immutable and, therefore, one cannot disregard any incidental convergence. Beyond this, it is necessary to emphasize that both models can give positive outcomes in terms of efficiency as long as the institutional framework is appropriate.

sector shareholders (including State interests in those cases where the government participates) in the top 10 domestic companies ranked by market capitalization exceed 50%, Chile being the only exception with a percentage of 48%.

[30] In countries with adequate protection, minority shareholders are more willing to pay higher stock prices because they know for certain that they have legal mechanisms in place which shield their investment from expropriation by controlling shareholders, even though they know that they cannot influence corporate policies. When minority shareholders are willing to pay for this premium, controlling shareholders will be more willing to finance themselves through issuing shares, diversifying and reducing their shareholdings, without fearing expropriation in case they might lose control over the corporation. Along these lines, high capital concentration would be a symptom of capital market malfunctioning.

[31] Apreda (2001) makes a thorough and detailed analysis of Argentina as a case in point and the process of reform carried out over the last years.

3. International Regulatory Trends

3.1. CG regulatory developments in the field of comparative law have been numerous and diverse and, in most cases, they have been designed for companies which publicly trade their securities[32]. In almost every case, the initial trend was that of promoting a broad range of deregulation and CG good practices, focusing on matters relating to attracting financial resources to the business firm. In this first stage, reforms were driven via codes or bodies of recommendations made by self-regulatory markets that would enact *soft law*[33], which was adopted by companies on a non-binding basis. The "self-regulation" approach has a long-standing tradition in the Anglo-Saxon world[34], especially since the Cadbury Report was published in the United Kingdom, which was then followed by other countries, including some traditional civil law countries such as France[35].

3.2. Another example of a country without an Anglo-Saxon tradition that initially adopted a system of recommendations in the form of a Code of Conduct was Spain, unlike other European countries which, like Italy[36] and Germany[37], favored the avenue for legal reform. It is expressly stated that the purpose of the announcer of such recommendations and the goals that one seeks to achieve by pursuing compliance therewith are purely orienting in nature, and *"recommendations shall never be subject to legislative regulation or imposed on recipients thereof, not even indirectly, through enforcement systems that may impair the non-binding character of the Good Governance Code* (Olivencia Code)[38]. This stance was later sustained by the Aldama Committee[39]. The justification for such argument is simple: the effectiveness of the non-binding principles-based approach exclusively depends on how companies welcome this position.

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[32] This has implied that, except for the recent legal reforms in Germany and Italy, regulatory changes have been driven by the securities market legislation, without there being a comprehensive amendment to company law standards.

[33] It purports to impose a set of ethical standards, which are not subject to legal controls or sanctions, and only take the form of recommendations. The underlying idea is that, although this "self-regulation" system has no associated legal sanctions for non-compliance if the company fails to adopt such recommendations, it shall entail reputational consequences for the firm. The adoption of good governance recommendations is a clear-cut signal conveyed to the market that immediately creates greater value as if it were the purchase of an intangible asset, the mere existence of which strengthens the firm's reputation and becomes a valuation component in the marketplace..

[34] Initially, based on the Anglo-Saxon experience, there was a growing consolidation of the opinion held by some sectors connected with the directors of large corporations who admitted the need for a change enabling to minimize a certain degree of excess and abuse against investors by adopting "good governance rules" ensuring greater transparency but having the feature that companies would adhere thereto on a "voluntary" basis, either because such standards do not constitute formal law or because they only imply "recommendations" deriving from the markets or bodies to which companies are affiliated.

[35] In July 1995, it was published in France the Vienot Report, named after the Chairman of the Committee, which consisted of senior officers from French leading companies.

[36] Relevant standards for listed companies in Italy are included in the Financial Intermediation Single Text, Legislative Order dated February 24, 1998, Number 58 and, more recently, regulations on company law reform, Act of Congress 366, dated October 2001, empowering the government to implement a company law reform by introducing a comprehensive amendment to the laws governing corporations and cooperatives.

[37] On March 25, 1998, the Corporations Act of 1965 was partly amended in order to enshrine transparency and enforcement rules in the business arena. In 2000, it was appointed a special commission chaired by law expert Professor Theodor Baums, which was commissioned to produce a report on German listed companies that was finally submitted in July 2001 and is known as Baums Commission Report. It contains 150 recommendations on legislative amendments and other proposals for a Company Law Governance Code. Following the Baums Recommendations, in September 2001 the Government appointed another commission chaired by Gerhard Cromme in order to formulate a German Company Law Code, known as Cromme Code, and drafted a bill, which was finally approved in July 2002.

[38] On February 28, 1997, the Spanish Cabinet (Council of Ministers) approved the creation of a Special Committee to prepare a Code of Ethics for Company Boards of Directors. Pursuant to a Ministry of Economy and Finance Resolution dated March 24, 1997, ten members of renowned qualifications and background were appointed to such Special Committee, chaired by Professor Olivencia. In February 1998, the publication came to light under the name of "Listed Company Governance."

[39] In early 2003, it was submitted the Aldama Report which includes a series of general comments on the current status of corporate governance in Spain and the degree of compliance with the Olivencia Code. It makes several recommendations without disregarding the "self-regulation" model followed by the Olivencia Committee, even though it proposes a legislative intervention in other matters, such as greater accuracy in the contents of fiduciary duties of directors. The Report's philosophy rests on three criteria or principles: (i) effective rule of law; (ii) market self-regulation, as much as possible; (iii) utmost transparency.

Recommendations will be particularly useful for those recipients who consider that the value of the organization increases as there is growth in control, transparency and, ultimately, willingness to exercise accountability.

3.3. Generally, traditional civil law countries have a higher degree of concentrated capital, less dispersed share ownership and dominance over controlling shareholders. In such case, it is improbable that the recommendation system make "the market" improve certain corporate practices by itself. For this reason, the non-binding principles-based approach may not be effective in countries having a cultural and legal system which is different from those prevailing in Anglo-Saxon countries (the source for Good Practices Codes). Recently, several empirical papers have cast doubts on the effectiveness of the "self-regulation" model. Contemporaneously, the market distrust about the impact of adopting such codes has been increasing due to various resounding corporate failures. For instance, evidence shows that in the Netherlands[40] the application of a self-regulatory initiative on CG matters by the private sector ("Petters Committee")[41] has seemingly failed to have significant impact on corporate value. These findings appear to indicate that one should not expect much from initiatives that are not supported by an adequate degree of effective regulatory enforcement.

3.4. At present, there is a dramatic trend toward enhanced investor protection via mandatory rule adoption, an alternative being instrumented as a "legislative solution" and materializing into legal standards of different rank, which are always binding. This second wave of CG reforms has included broader issues, such as protection of other stakeholders, the community at large, the environment, corruption and corporate ethics. This trend has deepened since the Sarbanes-Oxley Act was passed in the U.S.A.[42] The same happened in other European countries, like Spain, who have recently decided to favor binding standards. Although this regulation generates costs for issuers and investors, there is relative consensus as to the fact that certain areas should preferably be subject to legal regulation[43].

3.5. The self-regulatory approach may be inadequate in Latin America where, for the time being, there is neither proper protection of independent and minority shareholder rights and interests nor sufficiently developed institutional infrastructure. In many cases, it is necessary to create visibility and effective monitoring so that the adoption of corporate governance codes does not become a mere declaration of principles without any possibility of assuring sound commitment to such standards.

3.6. The current world trend seems to advocate for a pragmatic strategy: where the market has been unable to regulate itself properly (e.g., information disclosure requirements), minimized intervention should translate into reforms which would improve foreign investor protection, notwithstanding the need to encourage and favor self-regulation in a supplementary way and promote enhanced visibility of those who adopt such recommendations[44]. Ultimately, self-regulation or legislative solution should not be conflicting

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[40] Jong, A., DeJong, D. Mertens, G. and Wasley, C. (2004)

[41] Self-regulation initiative through transparency and monitoring, between 1996 and 1997, promoted by the Euronext Amsterdam Stock Exchange and the Dutch Securities Issuers Association. The Committee issued recommendations geared to increase effective management, supervision and investor control, purporting to strike a better balance between company managers and investors. A key element of the recommendations has been self-enforcement through market discipline. Authors Jong, A., DeJong, D. Mertens, G. and Wasley, C. (2004) mentioned that even if the government explicitly stated its decision to legislate in case self-regulation failed to have a real effect, self-regulatory efforts did not have any significant impact, except for new entrants who currently show a better CG structure, as compared with the average firm entering the market before the Committee was formed.

[42] As a reaction against the above-mentioned U.S. corporate scandals, on June 30, 2002, Congress passed the so-called "Investor Protection Act through Enhanced Accurate and Truthful Information Disclosure under Securities Market Laws and for Other Purposes", known as "Sarbanes Oxley Act", after the last names of the Congressmen who submitted the bill.

[43] In particular, those relating to duties and responsibilities of directors; accountability of insiders; minimum transparency and adequate disclosure requirements; independence of auditors and conflicts of interest of gatekeepers; etc.

[44] There is a large number of ways in which one can increase the "visibility" of the degree of firm commitment, for instance, by creating special listing segments with more stringent CG requirements (e.g., Novo Mercado in Brazil) or by promoting indexes or ratings concerning CG practices issued by independent bodies that are reliable to the market.

options but elements to be used jointly with a view to establishing minimum legal protection requirements within a given institutional framework and fostering more competition through different incentives that may reward CG improvements and make the benefits of adopting good corporate practices more tangible.

3.7. The recent reforms, even though of a different nature and always affected by the characteristics inherent to each country, are indicating certain common CG trends. In fact, most of the reforms involve changes in securities markets laws and, only by way of supplement, in company laws. The most remarkable exception is the case of Italy, where there has certainly been a truly overall reform on the business firm scenario. On the other hand, the applicable methodological approach has consisted in establishing general guidelines or principles, leaving in the securities market regulator's hands the task of completing and regulating a more detailed and specific body of rules. Although this method enhances flexibility when rules are enforced, its success is based on the assumption that there is and independent, autonomous regulator with adequate economic and human resources.

3.8. As regards the contents of the most recent reforms, they are indicative of some common trends such as: (a) Transparency: In relation to deepening the information disclosure principle, the reforms give much more importance to non-financial information (a clear example are the so-called CG Annual Reports), especially in relation to matters associated with ownership structure, board composition, information on related-party transactions, information on risk management and internal control systems, and more comprehensive information on the operation of shareholders' meeting and board of directors. It is also worth mentioning the greater accessibility and swiftness of information through cost-effective and easy-to-access mass media like the Internet. In many cases, the information standard is based on the principle "comply or explain", that is to say, compliance with good governance practices or explanation to the market for the reasons why there is no compliance; (b) Board of Directors: The increasingly consolidated trend consists in shaping the board as a supervisory body, with the presence of independent directors in key board committees (audit, nomination, remuneration, etc.), a clearer indication of directors' duty of loyalty and duty of due care and diligence (in many cases, even extending such fiduciary duties to other individuals such as de-facto directors, controlling shareholders, etc.), as well as in formally drafting the rules and regulations which govern the operation of the board and its committees; (c) Minority Shareholder Rights: Streamlining the shareholders' meeting and providing equitable legal treatment to minority shareholders. An example of this is mandatory Tender Offers (TOs) or take-over bids and the existence of special procedures to approve transactions in conflicts of interest (for example, related-party transactions, etc.). In this connection, there is a strong drive for a more active participation of institutional investors; (d) Audit: In this case, there is a trend to strengthen independence criteria for auditors and subject the latter to more stringent regulations other than professional self-regulation, thereby promoting a convergence of accounting systems toward international standards, in many cases by regulating the role of other professional service providers or gatekeepers (analysts, risk rating agencies, lawyers, etc.). Enhanced pressure on the accounting profession goes together with a broader scope of auditors' opinion, now also including corporate internal control aspects on which auditors must issue a public opinion to the market (Sarbanes-Oxley Act, Section 404); (e) Ownership Structure: More flexibility in certain common practices in international securities market law (for example, stock repurchase transactions, warrant issues, etc.); and (f) Privately-held Firms and Financial Intermediaries: An important discussion at international forums on the extension of good governance standards to these companies. Financial institutions acting in their capacity as public savings intermediaries have been a matter of concern not only for the systemic impact caused by banking crises, but also for the implications of the new financial regulations (such as Basle II) on risk management within banks. Large privately-held firms, for their part, should also be subject to more transparent practices to the extent that foreign financing providers have become more demanding in relation to company management. There is still a pending discussion to determine whether rules for privately-held firms should be similar to or more lenient than those applicable to publicly-traded companies.

The Growing Role of Boards of Directors in Good CG

3.9. One of the main CG participants in business firms is the Board of Directors. Directors are in charge of supervising the "corporate" management of the firm[45], a role which implies that the director should undertake the duty to manage (broadly speaking) or to oversee management (strictly speaking[46]). The Board has the legal responsibility and the duty to create value for the shareholders of the firm, by properly addressing and preventing agency problems that may arise between the various stakeholders, which may affect the attainment of such goal. The role of the Board has changed over the last years as a result of reforms geared to strengthen CG within companies. Recently, emphasis has been laid on restating the obligations and responsibilities of the boards of directors, including formal requirements and specific tasks, as well as minimum operational requirements[47] which, to a greater or lesser extent, have been adopted in recent legal and regulatory reforms, as well as in recommendations and codes of best practices[48]. In general, this restatement includes practical matters which may not necessarily translate into a better and effective operation of the board. However, minimum guidelines and requirements give a chance to make a proper internal design of the board, with better general incentives to improve effective operation thereof[49].

3.10. Legal and regulatory changes, as well as recommendations on best practices, provide for a more active role of the board in protecting the interests of shareholders and other stakeholders, by properly encouraging the board to act with loyalty and due care before the latter. The specific nature of the board role generally covers a broader legal responsibility, which is a direct consequence of resounding frauds in the international arena. In the case of Argentina[50], such responsibility includes enhanced punishment for breach of duty of loyalty (reversing the burden of proof in fraudulent cases), whereas for negligence cases it is possible for the firm itself to purchase insurance. At the same time, CG standards tend to identify the responsibility and personal behavior of each director, thereby minimizing passive responsibility of board members.

3.11. Changes in designated roles and responsibilities are reflected in specific requirements for and recommendations on the proper and effective performance of the board. Specific recommendations include a more direct relationship with management and administration of the firm itself, establishing contact in formal and informal meetings (including distance conferencing) and laying emphasis on the job done within committees, but including discussion of operational, trading, and other matters. It is required to enhance review and control of information being disclosed to the market, analysis and monitoring of external and internal auditor performance, and also greater involvement in strategic and financial planning -including selection and recruitment of senior management staff. Likewise, the board must ensure compliance with material legal and regulatory provisions, including those governing tax, labor, social and

[45] Corporate interest may be understood either in a broad or a strict sense. In the first case, the pluralistic, institutional or German doctrine-based conception includes not only shareholders but also workers and other stakeholders. In the second case, the monistic conception of corporate interest strictly refers to shareholders' interest. Argentina's Companies Act fails to be explicit in this regard. However, Executive Order 677/01 specifies that the board must pursue the "common interest of all its partners", thereby sustaining the second conception, and implying the legal responsibility to create value for the benefit of shareholders.

[46] In the most common case in which the company has hired a professional management team.

[47] For instance, "sub-organs" within boards, including directors with certain minimum qualifications (financial experts) and characteristics which may be indicative of their independence and impartiality vis-à-vis any conflict of interest. A clear example is the requirement for the creation of an Audit Committee being responsible for supervising disclosure of truthful information, monitoring and exercising internal control over the production of such information and the identification of risks which may have an adverse impact on the firm. Generally, in addition to the Audit Committee's reporting and auditing functions, the board must meet the requirement of including non-related or independent directors (this being regulated in Argentina by Securities Commission CNV General Resolution 400/02), as well as expert directors.

[48] For the Latin-American case, see OECD (2001)

[49] Along these lines, one may distinguish some basic characteristics which are included in the recommendations on good practices: to have a majority of independent directors, to monitor management activity and performance, to strike a proper balance between generalist and specialist directors being involved in specific committees, with the clear-cut primary goal of creating shareholder value.

[50] Olivieri, C. and Villegas, M. (2005)

environmental issues. Directors should keep abreast of the firm's current situation vis-à-vis the market, the operation of the different areas and the key management and financial indicators which, together with minimum expertise requirements, would allow making an accurate interpretation and assessment of accounting and financial statements.

3.12. Finally, one should take into account that effective compliance with its role by the board is something highly difficult to measure in practice. Changes include minimum operational requirements which should be in line with recommendations on best practices (even in Argentina) and relate such minimum standards to appropriate legal responsibilities. The operation of the Board of Directors and the proper assessment of board performance in terms of efficiency and effectiveness is a difficult matter to be measured empirically. International evidence shows that a suitable analysis requires weighing formal and informal aspects with a certain degree of subjectivity. However, effective boards are directly related to their transparent composition and action, their degree of independence and professionalism[51]. There is also an unresolved academic discussion on the causal relationship between the firm's earnings and the distinguishing features of an "effective board" due to the above-mentioned difficulty in capturing fundamental qualitative elements[52]. The key continues to be an appropriate "decision-making process", where independence, professionalism, dedication, transparency and accountability to shareholders/owners are only "signals" to show an effective board to the market, rather than a prerequisite to improve the firm's performance.

[51] Olivieri, C. and Villegas, M. (2005)

[52] In fact, as the board of directors is a "black box" for outsiders. There is no consensus on how to evaluate the decision-making process in the board, or the way in which the board is effective as a key decision maker within the firm. See Leblanc, R. (2004)

4. Legal and Regulatory Framework in Argentina

Companies Act and Securities Market Act

4.1. In Argentina, business firms are formally organized by the Companies Act 19550. This act virtually encompasses all organizational matters relating to companies such as formation, accounting standards, mergers, spin-offs and controlling relations between firms, share issues, shareholders' meetings, board composition, special committees, supervisory boards, shareholders' rights, dissolution, liquidation and winding up, and so on. The last comprehensive amendment to the original piece of legislation was Act 22903, passed in 1983 when there was no thorough discussion on which good CG principles should be included in a companies act. A recent bill submitted to amend Argentina's Companies Act includes specific matters concerning business organizations, most of the specific proposals being adapted from Executive Order 677/01[53].

4.2. From a formal standpoint, Argentina's Companies Act grants a set of balanced rights to the different business firm participants. For instance, in the case of shareholders it provides, inter alia, for: (a) directors' liability for actions which may be contrary to the firm's interest[54]; (b) shareholders' access to corporate information, specifically for monitoring and meeting participation purposes[55]; (b) sustaining shareholders' right to either accept or refuse financial information supplied annually[56]; (d) granting privileges and protective measures to shareholders in case of capital increase or exchange delisting of companies[57]; (e) defining general rules to avoid conflict of interest in case of shareholders occupying senior management or board positions[58]; (f) granting special rights at shareholders' meetings to minority holders of more than 5% ownership interest[59]; and so on.

4.3. Both, the board and board committees, have obligations and responsibilities to protect the firm's interest and shareholders' rights[60]. In regard to its structure, the board may be composed of one or more

[53] The analysis of the bills submitted to amend Argentina's Companies Act goes beyond the scope of this Policy Note.

[54] Section 59 of Argentina's Companies Act enshrines the standard of conduct for directors based on the obligation to act with loyalty as well as due care and diligence "as a prudent businessman." For its part, Section 72 of the same Act provides that the approval for the financial statements does not imply to approve of directors' day-to-day management, and Section 241 prohibits directors being shareholders to vote on the approval for their management of corporate affairs. Section 198 establishes responsibility of directors, managers and internal comptrollers (*síndicos)* for capital increases violating the securities public offering regime. Section 261 sets a cap on directors' remuneration. Section 271 specifies that directors must meet special requirements to contract with the firm, and Section 272 establishes that any director having an interest opposite to corporate interest must disclose it and abstain from discussion. Section 273 prohibits directors to conduct activities competing with the firm. For their part, Section 276 and following ones regulate liability actions, whether corporate or individual, against board members.

[55] Thus, Section 67 of Argentina's Companies Act provides that the financial documentation subject to approval at any shareholder meeting must be available to shareholders at least fifteen (15) days prior to the date set for the meeting. In turn, Section 294 sets forth the rights of the supervisory board to supply information on matters under its competence and inquire into complaints reported by shareholders representing at least 2% of capital stock.

[56] Section 69 provides that there shall be no waiver to the right either to approve or challenge financial statements.

[57] In order to protect shareholders against the risk of dilution, Section 194 of Argentina's Company Law establishes preemptive rights and the right to accrue as a rule that shall not be discussed by the parties. Section 195 provides for directors' joint and several liabilities in case shareholders are deprived of preemptive rights without a cause. In turn, despite it shall not be a binding provision, Section 202 empowers firms to issue bonus shares, which allows avoiding dilution of existing shareholders. At the same time, Section 245 establishes that, whenever companies publicly offer and list their shares, shareholders may exercise their right to withdraw or be removed (dissenters' rights) if the company voluntarily exits from public offering and listing, or the firm may continue to operate upon decision by the shareholders' meeting in case of deregistration from public offering and delisting from the exchange.

[58] Rules such as those established in Section 240, which provides that directors, internal comptrollers (*síndicos)* and general managers are obliged to attend shareholders' meetings, and Section 241, which prohibits said persons -when they are shareholders- to vote on actions concerning their management of corporate affairs.

[59] Section 236 empowers shareholders representing 5% of capital stock to request that a shareholders' meeting be convened, specifying the items to be included in the agenda and, should the meeting failed to be convened by the company, it shall be convened by any enforcement authority or competent court.

[60] Section 274 establishes the grounds for board liability.

members as set forth in the company's bylaws and which, at least, must be three in the case of publicly-traded firms[61]. In order to ensure minority shareholder representation, Argentina's Companies Act grants the right to cumulative voting for purposes of nominating board members. Thus, minority shareholders can accumulate their votes to elect up to one third of the board seats. However, where the bylaws grant the right to appoint directors who are shareholders of some special classes, the cumulative voting system shall no longer be applicable.

4.4. For their part, publicly-traded companies are under the scope of Argentina's Securities Commission (CNV), established pursuant to Act 17811 of 1968, which regulates and organizes the securities market in Argentina (Securities Market Act). This Act governs the activity of market traders. The CNV is empowered to issue regulatory standards for the capital market, and such rules are adopted and disclosed through General Resolutions that shape the dynamic body of market laws. The CNV is a self-regulatory governmental agency which directly reports to the Ministry of Economy and Public Works and Services (Executive Order 2060/1991).

4.5. The CNV is in charge of authorizing the public offering of marketable securities, keeping the register of companies authorized to issue securities under public offering and issuing standards which establish the compliance requirements to make public offering of stocks, corporate bonds and/or other marketable securities, thereby prescribing applicable reporting requirements. Likewise, the CNV performs ongoing governmental oversight over issuers, thereby providing its consent to any amendment to bylaws, capital increase, merger, spin-off and dissolution of companies. It also advises the National Executive Branch on licensing requests filed by stock exchanges and securities markets, approves the operational rules and regulations of such institutions and performs a supervisory function over their self-regulatory activities, among other powers[62].

4.6. The CNV oversees compliance with legal and regulatory securities trading standards and imposes disciplinary sanctions on issuers in case of breach thereof. For such purposes, the CNV has ample powers and it is entitled to demand the use of public force, start legal proceedings, report the commission of offences or crimes and become a plaintiff in court. The CNV is empowered to impose disciplinary sanctions such as censure, money penalty, maximum two-year suspension from public offering and prohibition to make public offering of securities. However, with respect to individual brokers and member firms, the CNV only has an indirect enforcement power because primary oversight power is in the hands of the Buenos Aires Securities Market itself, as a result of the robust "self-regulation" conception that traditionally advocated the Buenos Aires Stock Exchange.

4.7. Argentina's Companies Act and Securities Market Act only make a distinction between privately-held and publicly-traded firms –the latter listing their securities on stock exchanges- in a few isolated provisions. This matter has been subject to thorough reform in 2001 via Executive Order 677/01 (known as "Delegated Decree", DD), by establishing a specific legal system for companies going public on the securities market and regulating transparency aspects of the public offering regime and typical illegal actions such as insider trading, market fraud and manipulation, liability for defective prospectus; tender offers and stock repurchase market transactions; and a great number of standards to be complied by listed firms –including the mandatory creation of an audit committee formed by a majority of "independent directors"; a special procedure for related-party transactions; the obligation to publish an extended annual report; etc[63].

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[61] Section 284 establishes the grounds for board liability.

[62] It keeps record of individuals authorized to operate as OTC dealers and sets the requirements and conditions for their activity, as well as a general index of stock brokers registered with authorized securities markets; it approves creation and provides oversight of mutual funds; it approves creation and provides oversight of securities depositories; it approves creation and provides oversight of securities rating agencies; and it approves operation of self-regulatory organizations, whether based or not based on the stock exchange.

[63] See Kenny, M. and Villegas, M. (2001)

4.8. Until the DD enactment, corporate laws and rules were deemed to be formally acceptable, having noted[64] that one of the major problems was the degree of enforcement within an institutional environment with poor and low CG quality. The strengthening of the capital market institutional infrastructure is one of the key challenges still pending for the local market. One of the most novel DD proposals was precisely the establishment of arbitration proceedings that are mandatory for issuers and optional for investors, and which are designed to reduce the cost and time of legal proceedings and force each regulatory market to create its own dispute resolution mechanism.

4.9. Although international market traders who evaluate good CG issues have generally had a positive view on the amendments introduced by the DD, the reform failed to resolve structural matters concerning the organization of capital markets. This Executive Order did not cover related aspects geared to ensure economic resources, as well as appropriate legal guarantees which may grant independence to the financial regulator. At the same time, despite the fact that regulator oversight powers were enhanced, there was no discussion on the issue relating to direct supervision of market intermediaries.

4.10. Evaluating the scope and implications of the DD reforms leads to a positive outcome, even though many of the executive order provisions have not duly been regulated or there has been no assurance as to proper enforcement thereof by the CNV. There is also an evident lack of appropriate disclosure of some provisions such as those relating to mandatory arbitration as an alternative dispute resolution mechanism. The most positive aspects are undoubtedly associated with a modern notion of marketable securities and enhanced legal certainty provided by the new regulation on book-entry securities issues; the enactment of many statutory rules on transparency in public offering of securities, either by improving insider trading matters which, under the original regulation could not be applied by the Supreme Court (Terrabusi Case), or regulating the obligation to register shareholder agreements and be held liable for defective prospectus, which are absolutely ineffective under an ordinary civil liability system; or the extended annual report, which is now similar to CG Annual Reports, an area where the CNV has again failed to make regulation advances.

4.11. One should also mention the special treatment of issues concerning listed companies, from interpreting the concept known as “corporate interest”, particularly associated with shareholder interest, rather than occasional majority shareholder or controlling group interest; a modern management approach for publicly-traded companies by introducing a concept defined as “independent directors” and audit committees; enhanced accuracy of the implications of directors’ duties of loyalty and due care; all of which goes together with a strengthening of shareholder rights generally and shareholder meeting particularly. In addition, there is an inclusion of new minority shareholder rights, with special regulation of related-party transactions, one of the most serious weaknesses in the company law regime as regards conflicts of interest, and greater flexibility to adapt the ownership structure of public companies. On the other hand, one should further mention that little progress has been made to materialize structural market reforms, especially concerning regulator powers vis-à-vis self-regulatory powers, regulator independence and self-financing by the regulatory body. Weak effective enforcement of the legal framework continues to be the main obstacle to ensure a minimum degree of institutional CG good practices.

[64] De Michele, R. (2001)

5. CG Effective Enforcement

5.1. A peculiarly important aspect relating to CG good practices is the effective enforcement of laws and rules. This matter becomes particularly relevant in Latin-American countries, where the degree of institutional CG, transparency standards and corporate commitment itself, in most cases, are not consistent with best practices. Generally, the critical issues from a standpoint of effective enforcement of CG laws relate to: (a) the existence of an appropriate institutional and regulatory framework, including regulator independence and adequate requirements to access the securities public offering and listing system; (b) the presence of active institutional investors who are informed about the publicly-traded companies in which they invest; (c) the existence of action mechanisms granted to minority shareholders seeking redress against harmful behavior by controlling shareholder groups; and (d) the application of alternative dispute resolution methods which may expedite the protection of such rights[65].

Regulatory and Institutional Framework

5.2. The first aspect to be taken into account is the legal and institutional framework for the enforcement of CG laws. In Argentina, as it happens in other social and political environments, common knowledge sustains that good CG rules in force are not significantly behind those standards prevailing in countries with a comparable degree of development. However, at the same time, there is consensus on the fact that the greatest efforts should be made in order to assure law enforcement and a rule of law culture. Along these lines, the current status of the legal and institutional framework for the enforcement of CG laws cannot be regarded in isolation from other regulatory and institutional environments, but under the umbrella of the relative weakness of economic, social and political institutions at large, as well as the respect of the relevant leaders for well-established coexistence standards. Within such framework, it becomes particularly important that regulatory bodies lack the capacity to enforce rules and make institutions prevail.

5.3. Historical evidence shows that the State tries to intervene in many areas of social life, but its efforts generally prove to be highly ineffective, as it particularly becomes manifest in the CG area. In this regard, Table 2 shows the findings of a survey[66] which examines law and rule enforcement in Argentina, Brazil, Chile, Colombia and Peru. One of the comparisons related to the number of fines imposed by each securities market regulator in each sample country for the 2001-2003 period. Argentina's CNV was the regulator which imposed fewer money penalties throughout the three years[67], having a low ratio between regulated entities and employees. It is also surprising that this relatively "low" level of disciplinary activity by the CNV took place during a certainly traumatic period for all the agents involved.

[65] Osorio, J. (2004).
[66] "Survey on Enforcement Issues", Fifth Meeting of the Latin American Corporate Governance Roundtable. Blume, D. (2004).
[67] However, it should be noted that the Report states that many of such fines originated in minor offences, whereas substantial fines derived from sanctions imposed as a result of administrative proceedings, which totaled 313.

Table 2 – Enforcement in Latin America

	Argentina	Brazil	Chile	Colombia	Peru
Principal Supervisory Body	CNV	CVN	SVS	Supervalores	Conasev
Length of Term	7 years	5 years	no fixed term	no fixed term	3 years
Appointed by	Exec. Branch	President	President	President	President
May be Removed for/ if	seriousoffence	it is convicted	Yes, freely	Yes, freely	serious offence
Budget (in millions of US$)	2.64	25.8	9.08	5.4	7.86
Number of Employees	142	363	246	168	144
Supervised Entities	429	9,208	3,904	503	363
Supervised Entity/Employee Ratio	3	25.4	15.9	3	2,5
Fines Issued 2001-2003	27	5422	85	82	128
Fines Collected 2001-2003	13	1597	41	73	NA
Average Number of Fines (in US$)	Between 7 and	200,935	77,022	9,000	10,621

Source: Prepared with data from the Fifth Meeting of the Latin American Corporate Governance Roundtable

5.4. An issue to be taken into account is whether the regulator has the elements required to assure effective enforcement. Along these lines, it is necessary to say that the CNV oversight capacity was substantially improved via Executive Order 677/01 and General Resolution 400 of 2002, by including action rules in the CNV administrative proceeding regulation in case of initiation of summary proceedings by the Commission. Along the same lines, the CNV sanction powers were also improved. Executive Order 677/01 established new tools to enhance CNV supervision over the capital market. The following powers are included among the most important ones granted to the CNV:

(a) To require disclosure of information during an investigation. The breach of the duty of disclosure by the party involved in the investigation shall be deemed to be a conclusive fact confirming all the other circumstances existing in the course of such investigation. Any failure to cooperate which may be attributed to a person subject to investigation shall not be sufficient to sentence and convict said person, but it shall be deemed to be a material element both in any subsequent proceeding and the final decision thereon[68].

(b) To monitor systems implemented by self-regulatory organizations. The CNV must approve the monitoring systems and procedures established by self-regulatory organizations for individuals under their control.

(c) To approve trading system rules and regulations griten by self-regulatory organizations.

(d) To pronounce the irregularity or invalidity of any action subject to its oversight for administrative purposes, whenever such action is contrary to the law, CNV regulations, corporate bylaws and/or rules. This power was already vested in the CNV, but confined to its capacity as a regulatory body for publicly-traded corporations domiciled in Buenos Aires City, and in Mendoza Province[69] this power was discretionary[70].

(e) To preventatively suspend the public offering or trading of marketable securities whenever there are systemic risk scenarios or any other circumstances implying serious danger[71].

(f) To supervise the activity and independence of certified accountants and auditing firms (Section 12, Executive Order 677/01).

(g) Administrative proceedings and sanctions. The new regulation specifies in detail the administrative proceeding entrusted to CNV and it establishes a new sanction scale. Regulation highlights on this matter are as follows:
   - It imposes segregation of duties at the heart of the CNV: the division investigating facts and filing charges must be different from the division conducting examination in the administrative proceeding.
   - It facilitates the adoption of precautionary measures during examination stage.

[68] See Section 9 of Transparency in Public Offering Act, Title I, Executive Order 677/01.
[69] Pursuant to Act 22169.
[70] See Section 39 of the Executive Order. Amendment to Section 6 (h) of Act 17811.
[71] See Section 13 of Act 17811 (as amended by Transparency in Public Offering Act, Section 39).

- It allows continuing with the administrative proceeding initiated by the CNV even though a criminal proceeding may be underway on a parallel basis.
- The appeal of resolutions imposing fines as a sanction shall have a suspensive effect.
- The limitation period for actions originating in any violation shall become operative six (6) years after the commission of the offence, and the limitation period for any fine shall become effective three (3) years after notice of the final sanction[72].

(h) To establish specific reporting requirements, bearing in mind the nature of the issuer, the amount of the issue and the number or characteristics of investors to whom it is addressed[73]. Additionally, the CNV may exempt small and mid-sized enterprises (SMEs) from setting up an audit committee.

(i) To pay, in case of civil or criminal proceedings against CNV employees for action or omission in the discharge of their duties, reasonable costs the defence of said employees. In case the final decision resolves that the employee is subject to liability, the latter shall have to return the costs paid by the CNV.

(j) To legitimate the setting of fees for the CNV financing.

In this regard, the rules applicable to the other countries in the region that were included in the OECD survey seem to be comparable to the standards adopted in Argentina, concerning both oversight capacity and sanctionatory power.

5.5. In such context, it is important to discuss about regulator independence. This independence[74] must be political as well as financial, because the smooth operation of a regulatory body and law and its effective enforcement capabilities must not only be free from intervention by other powers and government agencies, but also have adequate financing to fulfil its duties efficiently and keeping suitable distance from individuals and entities under regulation. In this regard, significant advances were made through Executive Order 677/01, particularly as to regulator's autonomous budget. Section 47 of the above executive order established that the CNV may partially bear its expenses by means of oversight and control rates and registration fees, which had already been provided for in Executive Order 1526/98. The relevant rates and fees were fixed via Ministry of Economy Resolution 87/01. With the obvious purpose of avoiding spurious interest by the regulatory body, the new Section 10 "duo" of Act 17811 prescribed that fines imposed by the CNV be transferred to the National Treasury. It should be mentioned that this has not resulted in the self-financing of the CNV, which is still dependent on the budget allocations received from the federal government, even though we were unable to access material data on the percentage that the amounts collected as oversight and control rates and registration fees represent within its budget.

5.6. On the other hand, as it derives from the above-mentioned OECD regional survey (see Table 2), the Argentine regulatory agency is the one having the lowest budget among the five countries subject to comparison. From the political independence standpoint, it should be recalled that in our country the CNV is a self-regulatory agency reporting to the Ministry of Economy, and commissioners are appointed by the President of the Nation for a specified period of time (seven years). The main purpose of this rule is to give stability to its management body and, through such stability, assure its independence of political fluctuations outside the regulatory agency. Recent practical experience, however, indicates that in fact such independence has been threatened or even violated on repeated occasions.

5.7. Preventing unethical or illegal actions is less expensive and more efficient than curing them with medicine available after they have occurred. In the field of CG within publicly-traded firms, prevention is conducted through effective controls over their admission and continuance under the umbrella of public offering and listing of marketable securities. As regards transparency, the CNV standards would have a relatively acceptable status contrasted with the degree of domestic capital market development from the

[72] See Sections 10,12,14,15 of Law 17811 (as amended by Transparency in Public Offering Act, Section 39).
[73] See Section 44 of Transparency in Public Offering Act.
[74] OECD (2004).

viewpoint of registration requirements at the time of making a public offer. However, since the Argentine regime is based on a system of reporting "by issues", regular information on such issuers is very deficient. There are unfavorable situations from the viewpoint of regular information that must be made available to investors once firms are already admitted to listing, because there is no annual qualitative report, such as Form 20-f submitted by companies listing in the U.S.A. All this generates a bulk of public information that is very dissimilar within the same issuer universe, depending both on the quality of information and the presence or absence of recent issues. An example of the foregoing is that, for many issuers who list shares but have not marketed new shares for a long time, it is virtually impossible to obtain material public information, such as composition of ownership structure including real corporate control levels (as it could be determined when the TDI was prepared); even though the CNV Rules (Section 10 (c) of Chapter XXI) provide that the issuer's[75] final controlling individual(s) must be identified before March 1 every year. Transparency of and reliability on the information available to investors have significant implications for the participation of institutional (in particular, foreign) investors and small investors in the capital market.

5.8. Information available to investors, concerning its degree of extension and certainty, has major implications for the development of institutional investors and/or small investors who are increasingly and better willing to get involved in corporate life. However, the results obtained from preparing the TDI and the surveys on the listed companies indicate that, even though there has been regulatory progress through Executive Order 677/01, Argentina has not lived up to the expectations, firms confining themselves to comply with regulatory provisions (see survey findings and Transparency Index). The new Section 71 of Act 17811 established longer terms for calling shareholder meetings of publicly-traded firms and specified procedures for minority shareholders to participate in decisions made at general meetings. Even if there has been an improvement to legislation, as mentioned before, there is a certain degree of persuasion as to the need for greater regulator activism, for example, through its participation at general meetings. The same scenario would be applicable to disclosure of accounting data and financial information by issuers[76].

The Institutional Investor Role

5.9. Shareholdings have grown on a sustainable basis in the portfolios managed by institutional investors –pension funds, mutual funds, insurance companies- in many countries over the last years. As a result of the foregoing, institutional investors have significant equity (and voting) interests in the ownership of publicly-traded firms. Therefore, it is highly important to analyze their role as corporate monitoring agents, as ancillary tools in providing adequate rule and law enforcement and promoters of CG improvements within firms. This role played by institutional investors has clearly been put forward by the OECD (2004) and it involves two key aspects: (a) regulation on the investment policy of institutional investors –particularly, pension funds- and the exercise of rights and duties by institutional investors in their capacity as shareholders of the companies in which they invest funds under management.

5.10. Over the last years, pension funds have increasingly gained importance within the universe of institutional investors. The introduction of individual retirement accounts managed by professional experts was accompanied in most cases by regulations on the investment policy of such funds. In most cases, regulatory provisions established maximum shareholding limits depending on type of instrument and issuer. Additionally, in some countries such as Colombia and Chile, regulations set minimum requirements for transparency and disclosure of information by listed companies so that the latter could become eligible for investment by pension funds –like the Colombian case- or have access to more flexible quantitative limits regarding the investment policies of pension funds –like the Chilean case. In Argentina, regulation was shaped into maximum limits by type of instrument –of 50% of the fund in the case of domestic shares[77]- and also by type of issuer –maximum limit of 2.5% of the fund or 5% of equity

[75] Including first and last name, type and number of identity document or any identification document issued by their country and full address.
[76] Section 64 of Act 17811.
[77] Excluding privatized company shares which have a maximum limit of 20% of the fund under management.

or votes of the issuer-, in conjunction with qualitative limitations –such as the impossibility to acquire multiple voting shares or non-voting shares. Likewise, for companies to be eligible by pension funds, shares must have a minimum rating as "Category 2". This feature is important because the OECD survey does not show higher weightings given by rating agencies to CG-related matters at the time of rating publicly-listed shares. On the other hand, pension funds have unsatisfactory/poor perception about CG within domestic listed companies, this last topic being later analyzed with greater detail in Section 6 of this Policy Note.

5.11. Another aspect under consideration refers to the exercise of rights and duties by institutional investors in their capacity as shareholders of publicly-traded companies. Institutional investor activism is encouraged in several countries such as the U.S.A. where both the SEC – in the case of mutual funds- and the Department of Labor –in the case of pension funds- have regulated the activity of institutional investors in their shareholder role and the exercise of their rights and duties as such. In the case of Latin America generally and pension funds particularly, countries like Peru, Bolivia, Colombia and Chile have implemented standards designed to regulate the activity of funds as company shareholders, in some cases forcing them to vote and disclose their action at general meetings. In Argentina, pension funds are obliged to attend shareholder meetings in case they hold more than 2% of voting rights.

5.12. In Argentina, self-regulatory organizations would also have a lower degree of development compared with other countries in the region concerning listing requirements and adherence to international CG principles, particularly if we contrast them with initiatives such as the "premium markets" recently put in place in Brazil (see Box 1), where companies may be admitted to listing in special segments if they meet certain CG requirements, as established by the Sao Paulo Stock Exchange (Bovespa). In Argentina, the listing requirements of its most important self-regulatory market (the Buenos Aires Stock Exchange) have long remained unchanged, and this indicates a remarkable contrast with the dramatic changes that have lately affected most international markets, not only Brazil, but also Europe and the U.S.A. after the signing into law of the so-called Sarbanes-Oxley Act. All this shows that there is little commitment by securities markets themselves to promote incentives or initiatives which have to do with good corporate governance.

Box 1 – Brazilian Premium Markets

In 2001, the Bovespa (Sao Paulo Stock Exchange) created a series of market segments with additional standards implying regulatory CG requirements apart from those established under the legal and regulatory framework[78]. Depending on the level of commitment to such practices, corporations may choose to adhere to Tier 1, Tier 2 or *Novo Mercado*. Adherence to the additional rules is set forth in the listing regulations for each segment, the access to which is absolutely voluntary for new, as well as already listed, companies.

Tier 1

- To maintain a free float level not to exceed 25% of equity capital;
- To commit to maintain public offering for new issues;
- To improve information disclosure, including quarterly data, consolidated information and special audit;
- To enhance transparency of transactions involving majority shareholders or managers, as well as shareholder agreements and stock options plans;
- To provide an annual corporate action calendar.

Tier 2

- Obligations included in Tier 1;
- One-year single term of office for directors;
- Annual balance sheet pursuant to US GAAP or IAS;
- Equitable conditions for every shareholder vis-à-vis controlling shareholders, and at least 70% of such conditions for preferred shareholders (*partial tag alone*);
- Voting rights to preferred stock under special circumstances such as reorganization or merger, and approval for agreements between firms belonging to the same group;
- Obligation to extend the offering in case of closing equity or canceling registration as a Tier 2 firm;
- Adherence to the Premium Market Arbitration Panel as a vehicle to resolve corporate disputes.

Novo Mercado

- In addition to the requirements for admission Tier 2, companies must issue and list voting common stock only.

Migration by firms to segments with more stringent CG requirements reflects their direct commitment in terms of corporate governance. Empirical analysis[79] demonstrates that non-voting shares[80] (i.e., shareholders who might be more adversely affected by covered action or expropriation by shareholders entitled to voting) of migrating firms have a positive abnormal return. Voting shares show a negative abnormal return, thereby indicating the potential presence of a "premium for corporate control)". At the same time, there is an volume increase in the market (particularly, for non-voting shares). Finally, preliminary findings indicate that the implementation of premium markets may be a reasonable substitute for the issuance of assets in the American market (ADR issues) for Brazilian companies.

Minority Shareholder Protection

5.13. The most direct way of ensuring a high degree of compliance with rules concerning the protection of creditors and minority shareholders consists in facilitating the exercise of their rights when these are affected by illegal action. In Argentina, civil action rights vested in minority investors in legal proceedings involving public companies were traditionally established in Companies Act 19550. The key rights of action from this perspective are the action for invalidity against decisions adopted by the shareholder meeting and the action for liability against board members or company managers. In the latter case, the right of action may be exercised by the firm in case of damage caused to the company, even though it

[78] The most direct predecessor to Novo Mercado was the *Neur Markt* established in 1997 by the Frankfurt Stock Exchange, as a listing segment with additional CG requirements focused on primary issues. After experiencing a boom period as a result of the IT bubble, this market segment collapsed and was finally closed down in 2002.

[79] Carvalho and Pennacchi (2004)

[80] In Brazil, most companies issue shares of two classes: (a) voting shares (corporate bonds) and (b) non-voting shares (commercial paper) which cannot exceed more than 2/3 of total shares and must pay 110% dividends against voting shares. Generally, a family or a financial institution holds most of the voting shares, whereas the remaining voting shares are distributed among institutional investors (many of them, foreign investors) and, therefore, have low turnover. Ownership of non-voting shares tends to be more dispersed and record higher turnover.

may be used as a derivative action; which means that, in case of inaction by the company, the right of action may be initiated by an investor having indirectly affected interests. Likewise, there is an individual right of action which either shareholders or third parties may exercise against directors or managers in case of direct damage caused to them by the latter. Finally, the Companies Act enshrines the right to request that the company be subject to court intervention, as a precautionary measure in case that, as a result of any acts performed by directors or managers, serious danger might arise for the company.

5.14. In the case of publicly-traded companies, the framework provided by the Companies Act proved to be extremely general and ineffective for the complexities which characterize capital markets, and even unpractical at the time of granting rights to minority shareholders. Executive Order 677/01 entailed advances from such viewpoint, thereby extending available resources to minority investors in order to protect their rights. An example of this refers to the corporate liability action which in public companies may be exercised to claim for the company's benefit redress for the total damages suffered by the latter or to claim for partial damages indirectly suffered by the shareholders in proportion to their shareholdings; in which case compensation for damages shall be added to the shareholder's wealth. This allows solving the problem raised by the existence of a mandatory court rate which, otherwise, should have been paid by the minority shareholder on the total amount of the damages suffered by the company. However, it is essential to verify whether such advances may translate into better effective enforcement of minority shareholder rights before the courts. Other rights of action were also established in case of prejudice against minority shareholder interests. It should be noted that these rights include, inter alia, the right to claim redress vested in minority shareholders damaged by related-party transactions carried out in violation of the procedure set forth in the Executive Order (Section 73 of Act 17811); the right to file a claim in case of mandatory acquisition of residual ownership interests (squeeze out) or removal from the registration and listing system, where minority shareholders are not paid a fair price for their shareholdings (Sections 25 to 32 of Executive Order 677/01); and the right to recover profits obtained by directors and insiders who make use of privileged information for their own benefit or the benefit of third parties (Section 33 of Executive Order 677/01.)

Dispute Resolution Mechanisms

5.15. As to dispute resolution mechanisms, it has been acknowledged that in Argentina courts of justice, both federal and provincial, usually lack resources and are viewed as ineffective, inexperienced and poorly qualified when they have to evaluate and settle disputes arising from financial issues. This inevitably results in the fact that minority shareholders or other outsiders in connection with the management of publicly-traded companies find it difficult to fulfill their expectations as to appropriate redress of their damaged rights. This has drawn attention to alternative dispute resolution mechanisms; particularly, mediation and arbitration. In such context, "the legal framework should address and remove the obstacles for an efficient use of private arbitration and other potentially effective mechanism to resolve disputes among shareholders"[81]. For virtually one decade already, the Argentine federal justice has instituted binding mediation through Act 24.573[82]. In turn, for relations between companies listed on a self-regulatory market and their shareholders and investors, Executive Order 677/01 established mandatory jurisdiction for standing arbitration panels created under the scope of such self-regulatory organizations[83]. For purposes of attaining enhanced quickness and efficiency in resolving corporate disputes and conflicts raised between securities issuers or underwriters and investors, arbitration was prescribed binding for issuers and optional for investors[84]. Arbitration is also applied for conflict resolution between investors and self-regulatory organization agents. Within a term of six (6) months from the

[81] OECD (2004).
[82] It has been acknowledged that the binding mediation procedure has proved to be positive to relieve pressure from action by judges, but other factors such as lack of resources, specialized education and training have made such changes less remarkable.
[83] The Code of Commercial and Civil Procedure of Argentina establishes that arbitration awards are efficient and binding, a notion that has only recently been acknowledged in other countries of the region.
[84] See Section 38 of Transparency in Public Offering Act.

publication of said Executive Order, all self-regulatory organizations must set up a standing arbitration panel. Although investors may choose to resort to state justice, in cases where joinder of action is applicable, it shall be conducted before the arbitration panel.

5.16. Unfortunately, the 2001-2002 economic crisis made it impossible for arbitration panels to conduct a more positive action regarding CG issues. By way of example, one should mention that in October 2004, out of approximately 60 cases being tried by the Buenos Aires Stock Exchange Arbitration Panel, only four of them were connected with CG issues, the remaining cases being associated with disputes deriving from the peso-conversion of foreign currency-denominated bonds established by the federal government after the default crisis. However, one should also note that it is highly difficult for these alternative mechanisms to become absolute remedies for the resulting the administration of justice and legal certainty crisis, particularly bearing in mind the need to claim in court for the execution of binding arbitration awards. Moreover, in many cases arbitration panels (especially, institutional versus ad-hoc panels) ended up having the same shortcomings or defects as those affecting the administration of justice. From this viewpoint, it is always advisable to invest in training human resources and, generally, in improving administration of justice.

Other Effective Enforcement Mechanisms

5.17. As we have seen before, in developing countries with institutionally weak environments, CG must mitigate not only problems concerning the protection of ownership rights for all corporate financing participants, but also issues on conflict resolution among them. International evidence seems to indicate that in countries having difficulties in preserving ownership rights and administration of justice, there is no smooth operation of mechanisms to resolve disputes among corporate participants[85]. Along such lines, concentrate corporate ownership in developing countries may be considered as one of the principal effective enforcement mechanisms, whenever one analyzes potential conflicts of interest among the various stakeholders. In this sense, legal and regulatory measures which may enhance protection given to minority shareholders must be accompanied by appropriate development and reinforcement of dispute resolution mechanisms. Generally, concentrated ownership determines that corporate control markets fail to function as disciplinary mechanisms in practice, as it happens with proxy voting rights. Concentrated ownership also affects the activity of the board in its oversight capacity and the possibility of using compensation to executive officers as disciplinary instruments. In such contexts, there are other mechanisms which may provide a higher degree of effective enforcement, such as activism of banking institution, employees, societal control and the Press. In the case of banks, they may play a key role because, generally speaking, in countries where institutions are weak, banking exercise dominance over financial services and corporate financing. However, the role that banking institutions may play to reinforce control directly relates to their own CG [86]. On the other hand, employee activism could be a potential mechanism of control, even though it heavily depends on the degree of transparency, the situation of labor markets and the possibility of participating in the board of directors. Societal control and the Press should not be underestimated, but they critically depend on the degree of financial education, the customary level of competition among mass media, as well as advertising campaigns that emphasize the importance of governance best practices for the protection of minority shareholders and other corporate stakeholders.

5.18. Finally, it is necessary to mention the role that gatekeepers, auditors, accounting advisors, rating agencies and other consultants play in the effective enforcement of good CG standards. These persons provide monitoring, disclosure and certifications services in relation to companies[87]. Appropriate compliance with this role requires control over the potential discretionary cash flow management within

[85] Berglof and Claessens (2004).
[86] Caprio, G. y R. Levine (2002)
[87] Coffee (2002)

companies by majority shareholders or senior managers (who usually have more information available). The potential conflict of interest that may arise in monitoring and control may partly be solved by the reputational equity that the intermediary puts at stake when he performs his job. However, evidence on the latest crises shows that this argument fails to be adequately sound in practice. In the case of auditors, international trends advocate for limiting the possibility of providing additional consulting services to the firms. In the case of accountants and lawyers, monitoring should go beyond certifying appropriate formal enforcement. Along this line, evidence demonstrates the importance of adopting transparent standards in line with best practices and adequate requirements for ethical professional practice. Lastly, as part of corporate assessment, rating agencies should thoroughly examine the existence of appropriate CG control.

6. CG Stylized Facts in Publicly-Traded Companies

6.1. Compared with other countries in the region and emerging markets, Argentina's capital market records a low level of development. As it can be seen in Table 3, the Argentine capital market has a low level of domestic issues, listed companies, market capitalization and trading volume, whereas concentration is higher than the one occurring in other reference groups.

Table 3 - Capital Market Indicators: Argentina and Selected Regions (Year 2004 in % GDP)

	Argentina	Developed Countries*	Latin America (excl. Argentina)	Other Developing Countries**
Domestic Issues (in % market cap)	0.5	1.5	0.9	2.5
Number of Listed Companies (2004) on Las	107	2657	257	534
% Fluctuation - Number of Listed Companies (2004-2003)	-2.7	0.9	6.7	6.6
Trading Volume (in % GDP)	3.2	166.8	10.6	52.0
Domestic Shares	3.0	146.5	10.5	51.9
Foreign Shares	0.2	20.3	0.1	0.1
Market Cap - Domestic Companies (in % GDP)	26.7	134.0	42.9	65.9
Market Concentration				
Top 10 Companies - % Market Cap (on average)	79.3	45.6	52.9	51.2

* United States, Canada, England, Germany, Spain, Italy, Japan.
** Poland, the Philippines, Singapore, Thailand, Korea, Malaysia.
Source: CFS based on World Federation of Stock Exchanges and Argentina's Ministry of Economy.

6.2. The relatively low degree of capital market development is closely related to the CG quality, so that there is a causal relationship moving in a twofold direction: on the one hand, poor CG reduced securities demand by investors and, on the other hand, scarce market development discourages CG commitments by firms because they perceive that a shallow market fails to value CG improvements accurately. Along these lines, companies find few incentives to improve transparency and CG, whereas investors are unwilling to invest in a slightly transparent market. Therefore, any improvement in the legal framework and communication to the market of corporate culture in terms of governance best practices could translate into greater participation in the capital market.

6.3. Individual holding of marketable assets by domestic agents reached a level of 6.1% of GDP throughout 2003[88], whereas direct holding of shares only accounted for 2.9% of GDP, thereby reflecting scarce participation by individual investors. In fact, only 5% of the financial wealth of Argentine people is allocated to marketable assets on a direct basis. This figure contrasts with the 60% of the financial wealth that Argentine residents hoard in foreign assets. For their part, 29% of financial wealth is intermediated through domestic financial services, 60% corresponding to bank intermediation.

Corporate Ownership Structure

6.4. The ownership structure of corporations is increasingly topic of interest in CG literature, largely justified for two reasons: (i) concentrated or dispersed ownership is an indicator of the institutional quality of any country (in particular, if small investors are unprotected, one should expect strong concentrated ownership); and (ii) the degree of concentrated ownership, especially the segregation between voting rights and equity rights, increases the incentives to subject minority shareholders to expropriation. Following the methodology proposed in a paper by La Porta et al. (1999), for the first time in our country, a

[88] Analysis of Argentine Financial Wealth. Technical Note 6. CEF. September 2004. Page 7.

research was conducted into the ownership structure of non-financial publicly-traded firms[89] in Argentina. Limited data made the task difficult, since the regulator does not require that ownership structure be disclosed by public firms. Companies listing ADRs[90] must submit Form 20-F where, among other information, there is a description of the firm's ownership structure. However, for companies which are only listed on the local market, regulation establishes that they must report any changes involving more than 5% of capital stock[91] but, even in such cases, they are not obliged to report on those shareholders who are not directly involved in the transaction.

6.5. La Porta et al. (1999) and subsequent papers develop an approach to identify the ultimate owners of each company with a view to establishing the degree of concentrated ownership and the differences between equity rights (*cash flow rights*) and voting rights (*control rights*). This difference arises from the use of pyramidal ownership, deviations from a one share-equals-one vote basis, and cross holdings. This type of analysis entails the need to identify both direct and indirect shareholders up to reaching ultimate corporate owners. In the case of Argentina, as State-owned enterprises have been privatized and there are no domestic companies with broadly atomized shareholdings, one can distinguish two types of ultimate owners: Argentine families and foreign firms. Por each firm, stemming from its direct shareholders, a shareownership research was conducted up to finding a family or Argentine individual and/or a foreign firm.

6.6. Table 4 summarized the ownership features observed for 54 publicly-traded non-finance companies with comprehensive information about their ownership structure. The outcomes show that ownership structure in Argentina is relatively simple, with firms that are typically controlled by their ultimate majority shareholder, who holds on average 63% of votes and 57% of equity. Voting rights fail to be 30% higher than equity rights, but the percentage hikes to 74% when we only consider those companies (22 out of 54 in total) where the ratio between voting and equity rights exceeds 1.02. This gap is largely the result of pyramidal structures (observed in 37% of the sample) and, to a lesser extent, the result of multiple voting shares (11% of the sample.) There are no cases of cross holdings or firms with dispersed ownership, the latter being defined as companies which do not have any ultimate shareholder with more than 20% of votes. The ultimate majority shareholder is an Argentine national only in 46% of the sample, the rest corresponding to foreign firms[92].

Table 4 - Ownership Structure in Argentine Companies*

Variable	Median	Stand.Dev.	Minimum	Maximun
Voting rights of final majority shareholder (in % of total amount)	63.14	23.24	20.75	99.14
Equity rights of final majority shareholder (in % of total amount)	56.90	26.58	4.31	99.14
Voting rights on equity rights of the final majority shareholder (Ratio)	1.30	0.74	1.00	5.43
Voting rights on equity rights of final major shareholder (higher than 1,02;Ratio)	1.74	1.03	1.03	5.43
Companies with multiple voting shares (in % of total amount)	11.00			
Companies with pyramidal ownership structure (in % total amount)	37.00			
Companies with cross shareholdings (in % of total amount)	0.00			
Companies with dispersed ownership (in % of total amount)	0.00			
Companies whose final majority shareholder is Argentine (in % of total amount)	46.00			

(*) Based on 54 non-financial firms which provided comprehensive information on ownership structure.

Source: CFS

[89] For this reason we used several information sources, both public and private, including annual reports, issuance prospectus, companies' financial statements, forms required by local and foreign regulators, company and other websites, business newspapers and magazines.

[90] American Depositary Receipts (ADRs) are marketable certificates representing ownership of one or more shares of a foreign company (referred to as underlying shares.) The securities are traded on the main U.S. markets (NYSE, Nasdaq, AMEX) similarly to other American securities. ADRs were created in 1927 to grant the American investor the chance to invest in foreign companies and they are regulated by the SEC.

[91] Section 12, Chapter XXI, Volume 6 of the CNV Rules.

[92] In this last case, its ultimate shareholder was not identified because it was regarded as irrelevant for this paper.

Composition of the Boards of Directors

6.7. The survey conducted in terms of board composition (see Table 5) shows substantial deviation in the number of directors. The trend is three (3) directors, a number which is consistent with the minimum requirement established by the Companies Act for publicly-traded firms. Likewise, due to the fact that corporations need to adapt themselves to the CNV requirement for setting up an Audit Committee before 05/28/2004[93], the number of independent members matches the required minimum of two (2). It should be noted that in the survey conducted throughout 2003, before the CNV requirement became operative, the average number of independent directors was equal to zero (0). This indicates that the most usual trend in terms of board composition as well as number of independent directors has strictly adjusted itself to meeting the legal obligation imposed by the institutional CG framework.

Table 5 - Basic Statistics on Board of Directors Composition

Statistics	Directors (2004)			Directors (2003)		
	Total	No.Indep	%	Total	No.Indep	%
Average	7	2	36	6	1	27
Median	7	2	29	6	1	17
Mode	3	2	29	3	0	0
Maximum	19	7	100	19	6	100
Minimum	3	0	0	3	0	0
Median Spread 2004-2003	0.57	0.053*	0.03*			

Source: CFS

6.8. Throughout 2004, as shown in Tables 5 and 6, there has been a slight increase in the number of directors and a greater amount of independent members against the preceding year. In fact, in 22 firms the number of directors increased, whereas in 32 companies the number of independent directors went up, so that in only 34 firms there was a hike in the participation of independent directors in boards of directors[94]. This improvement is based on the above-mentioned need to set up an Audit Committee consisting of a majority of independent directors. Despite such requirement, only 36% of directors act in such capacity. In 24 cases there were [95]affiliate non-independent directors, a circumstance which is very common in Latin America because of pyramidal ownership structure[96].

Table 6 - Composition and Size Changes in Boards of Directors

Board of Directors	IIncreased	Reduced	Unchanged	No Information	# of Companies
# of Directors	22	8	51	-	81
# of Independent Directors	32	10	30	9	81
% of Independent Directors	34	10	28	9	81

6.9. International evidence shows that board size is proportionately related to company size and industry complexity. In this survey, the simple correlation coefficient between number of directors and asset value is 0.55, whereas correlation between number of directors and sales turnover is equal to 0.47.

[93] General Resolution 402/02.
[94] The increased involvement of independent directors proved to be statistically significant. In turn, statistics on average differences showed that the average director spread is not significant, whereas it is important in the number of independent directors and their involvement in the board.
[95] Afílliate Director is an important shareholder or an auditor or person related to the company auditor.
[96] Lefort, F. (2002) "Annex C: Equity Structure and CG in Latin American Countries – An Empirical Vision."

6.10. As it can be seen in Table 7, considering the 48 firms with more assets[97], those in which AFJPs invests (24 out of 48 companies) show a higher number of directors and a higher percentage of independent directors. This outcome matches the aprioristic expected figure bearing in mind the role of institutional investors as agents monitoring good CG (even though it is feasible that the causal relationship runs in the opposite way.)

Table 7 - Influence of AFJPs on Boards of Directors

Statistics	With an AFJP as Shareholder			With no AFJP as Shareholder		
	Directors	No. Indep	% Indep	Directors	No. Indep	% Indep
Average	8.9	2.5	31.5	7.3	2	31.2
Median	8	2	28.6	7	2	28.6
Mode	7	2	28.6	7	2	28.6
Maximum	19	7	66.7	14	4	66.7
Minimum	5	1	5.3	3	0	0

Source: CFS

Transparency and Disclosure Index

6.11. With the purpose of having an objective quantitative measure which may allow monitoring of CG evolution within firms in Argentina, the CEF has developed the Transparency and Disclosure Index (TDI)[98], the first corporate governance index specifically prepared for Argentina. Based on publicly-disclosed information, the TDI has three distinguishing advantages in that (i) it is unbiased and clearly documented, (ii) in a country like Argentina where disclosure requirements are low and mainly limited to accounting information, the TDI reflects non-binding, rather than binding, information and, therefore, it can disclose more variability between firms, and (iii) it is not affected by the response rate to the surveys directly addressed to companies, which is generally low.

6.12. On the other hand, the TDI has certain limitations. First, it does not facilitate to identify the CG features that any company has decided not to disclose publicly. For this reason, such index is supplemented by two additional indicators, surveys directed to firms themselves as well as to investors and market participants. Secondly, both information collected and information weighted may be subject to discussion.

6.13. The TDI was measured on two occasions: the first one between the months of August and November 2003, and the second in August-September 2004[99]. The analysis of ITD comparative evolution, including additional information from the company survey and the institutional investor as well as market participant surveys, shall allow to properly characterizing the CG level within publicly-traded firms in our country.

6.14. Table 8 shows the percentage of positive response to each of the brackets included in the TDI comparatively for 2003 and 2004. It can be noticed that the TDI ranking improvement between both years directly relates to more available information on factors such as the formation of an audit committee[100] by

[97] Considering the above-mentioned positive correlation between number of directors and company size, we used a sub-sample of the top 48 firms with more assets (AFJPs invest in 24 of them.)

[98] Transparency and disclosure of information is one of the key components of good CG because it facilitates better monitoring and control over the firm, management and controlling shareholders by minority shareholders, agents with a legitimate corporate interest and investors at large. See Patel, S. and Dallas, G. (2002).

[99] The results of the first measurement were presented on an aggregate basis at the CEF Second International Seminar. See Bebczuk, R. (2003).

[100] Pursuant to the provisions set forth in CNV Resolution 400/02 (Section 17), corporations categorized as small and mid-sized enterprises (SMEs), in terms of Economy Ministry Resolution 401 dated November 23, 1989, as amended,

a large number of firms (out of the 81 rated companies, 50 currently have an audit committee in place); compliance with the reporting requirement stipulated by Executive Order 677/01 concerning disclosure of dividend policy, senior management and board remuneration, even though it must be stated that in a large number of firms disclosure of such information is very limited; and the above-mentioned increase in the number of independent directors after the formation of an Audit Committee.

Table 8 - Information collected for the Transparency and Disclosure Index (TDI) (*)

Positive Response Percentage by Information Block	TDI-2003	TDI-2004
A. Board Structure and Procedures		
Code of Conduct for Directors	7.4	8.6
Director Independence Determination Criteria	82.7	97.5
Remuneration for Senior Management and Directors	56.8	80.2
Remuneration Payment Method (cash, shares, etc.)	11.1	17.3
Remuneration Calculation Parameters for Senior Management and Directors	25.9	27.2
Information on Performance-Linked Remuneration	25.9	37.0
Description of Shareholdings belonging to Managers and Directors	21.0	22.2
Number and Percentage of Independent Directors	90.1	97.5
Description of New Director Nomination Procedure	9.9	7.4
Composition of Board Committees	34.6	63.0
Description of Board Committee Activity	4.9	7.4
Information on Seniority of Directors in their Positions	16	19.8
Report on Dissenting Opinions at Board Meetings	0.0	0.0
Positive Response Average	29.7	37.3
B. Information Disclosure		
Description of New Director Nomination Procedure	13.6	23.5
Schedule of Major Events for Shareholders	2.5	1.2
Top Management Bio	17.3	16,0
Director Bio	19.8	21.0
English Version Website	28.4	32.1
Recent Historical Evolution of the Main Company Variables	98.8	98.8
Strategic Planning, Earnings Targeting and/or Forecasting	43.2	29.6
Publication of Board Minutes of Proceedings	95.1	100.0
Publication of Shareholder Meeting Minutes of Proceedings	92.6	100.0
Itemized Description of Attendance to Shareholder Meetings	32.1	22.2
Report on Dissenting Opinions at Shareholder Meetings	33.3	35.8
Recruitment Year for the Current External Auditor	100.0	98.8
External Auditor's Opinion	97.5	100.0
Composition of the Supervisory Board (internal o external comptrollers)	97.5	93.8
Description of the Supervisory Board Activity	2.5	7.4
Market Relations Manager Bio	8.6	13.6
Positive Response Average	48.9	49.6
C. Shareholders		
Document on Internal CG Practices Director	4.9	7.4
List of Majority Shareholders and their Respective Interest	59.3	77.8
Type and Number of Outstanding Shares (common, multiple voting, preferred, class)	98.8	98.8
Recent Historical Evolution of Dividend Policy	21.0	17.3
Projected Dividend Policy for the Next Years	25.9	33.3
Explanation for Past and/or Future Dividend Policy	35.8	39.5
Positive Response Average	41.0	45.7

(*) The reported numbers correspond to the percentage of companies which provided public information regarding each bracket under study.
Source: CFS

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are exempted from setting up an Audit Committee. In the first meeting of the board of directors for each fiscal year of corporations categorized as SMEs, the board must state, with the scope of an affidavit, that those firms meet the requirements for SME categorization. Within FIVE (5) days, a copy of the board minutes of proceedings must be sent to the Commission and self-regulatory organizations where the SMEs list their shares. Failure to comply with such obligation shall cause the exception herein prescribed to lapse automatically for such fiscal year. The basis for defining an SME is established in Economy Ministry Resolution 208/93.

6.15. Analysis of comparative general statistical data allows inferring that, even though there has been a significant improvement between 2003 and 2004 (see Chart 1), the level of CG within non-financial publicly-traded firms is relatively low. As it can be seen in Table 9, index average is higher than index median (the value that divides the sample by a half), which in turn is higher than the mode (the value repeating itself more times), thereby showing concentrated distribution in low index values, as it can be noticed in Chart 2.

Chart 1: TDI Fluctuation between 2003 and 2004

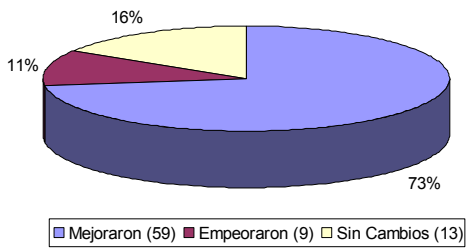
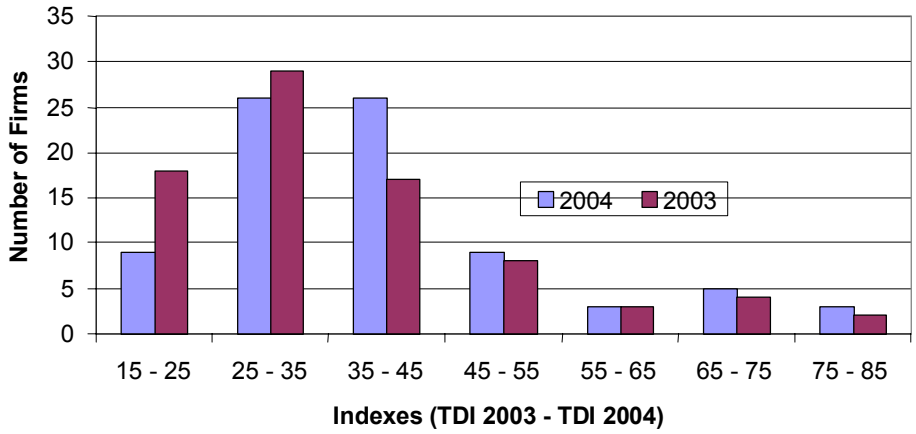


Table 9: Transparency and Disclosure Index

Statistics	TDI-2004	TDI-2003
Average	40.63	36.70
Median	35.81	33.33
Mode	33,.3	33.33
Maximum	85.19	82.72
Minimum	19.75	16.05
p-Value	0.21	

Chart 2: Number of Companies ranked by TDI



TDI Group Analysis

6.16. From the analysis of ratings given to companies by groups, one can derive interesting conclusions about the characteristics of CG[101] practices in our country. As it can be seen in Table 10, there are significant differences in the level of CG, as measured by the 2004 TDI, consistently with, inter alia, the following attributes[102]: (a) if firms have issued ADRs; (b) if firms have a capitalization level above the median; (c) if firms have risk-rated shares; (d) if firms have AFJPs as shareholders; (e) if the general manager (CEO) is a member of the board of directors. All these characteristics determined major differences among companies, but the analysis shows no statistically significant differences regarding the

[101] The rating difference is statistically significant
[102] Regarding firms which do not have such attribute.

level of freely floating shares (free float), debt over assets, existence of multiple voting shares, and nationality of majority shareholder.

Table 10 - Analysis by Company Group

Characteristics	Number of Firms	Average Rating	p-value Median	Spread
Cap above Median	**40**	**39.35**		**0.00**
Cap below Median	**41**	**26.63**		
Free Float above Median	40	31.40		0.27
Free Float below Median	41	34.39		
Risk Rated Shares	**39**	**39.69**		**0.00**
Non Risk Rated Shares	**42**	**26.62**		
Firms listing ADRs	**10**	**56.50**		**0.00**
Firms failing to list ADRs	**71**	**29.59**		
Bank Debt/Assets above Median	40	33.95		0.31
Bank Debt/Assets below Median	41	31.90		
Firms with AFJPs as Shareholders	**24**	**40.88**		**0.00**
Firms without AFJPs as Shareholders	**57**	**29.60**		
Firms with multiple-voting shares	30	32.00		0.55
Firms without multiple-voting shares	51	33.45		
Firms with Domestic Majority Shareholders	34	32.47		0.94
Firms with Foreign Majority Shareholders	48	32.29		
CEO and Director	**23**	**42.39**		**0.00**
CEO but not Director	**17**	**33.53**		

Note: Statistically-significant spreads are shown in bold type.
Source: CFS

6.17. Evidence shows that companies where the general manager (CEO) is also chairman of the board of directors have a TDI value which is significantly higher than the rest. Generally, good practices recommend that the two functions should not be discharged by the same person, for reasons associated with the workload and, basically, the need to keep a proper balance between responsibilities and controls. However, empirical evidence is not conclusive. In fact, Leblanc (2004) stresses the importance of the efficiency assessment of board performance over any assessment strictly based on formal board composition. The study shows that CG and company performance increase when consideration is given to issues such as CEO leadership and qualifications, director business knowledge and director independent judgment in decision making scenarios.

Table 11 – Comparison between Economic Sectors

Sector	Number of Firms	Average Rating	(p-value) Median
Holding Companies	**5**	**41.0**	**0.07**
Public Utilities	**20**	**39.3**	**0.02**
Aggregate Sample	81	32.9	
Service Sector	15	30.3	0.21
Industry Sector	27	30.0	0.14
Commodities Sector	14	28.4	0.10

Source: CFS

6.18. When firms are analyzed by productive sector (see Table 11), one can notice that holding companies and public utilities have a TDI which is significantly higher than the remaining sectors. In the first case, this could be due to the holding company's need to meet higher disclosure requirements from different regulatory authorities, including agencies from several countries. In the second case, the reason is the existence of specific regulatory bodies for public utilities. On the one hand, primary sector firms have a lower rating thant the average of the remaining sectors, but with a slightly significant difference.

CG Company Survey

6.19. With the purpose of supplementing the TDI, the CEF designed a survey[103] for publicly-traded non-financial companies to examine their CG practices, business ethics, risk management and market relations. The survey consists of 77 questions to be answered by companies themselves. These questions involve CG aspects that in most cases could no be examined through publicly available information. For this reason, information deriving from the company survey constitutes a necessary supplement to the TDI as a component of any CGSI construction. It should be noted that the information obtained through the survey is confidential for the CEF, whereas the answer to the proposed questions is a strictly voluntary decision made by the company. In this sense, the decision to accept and answer the questionnaire is a clear-cut indicator of the company's degree of commitment to disclosing and making relevant information transparent to the market.

6.20. The survey was distributed by the CEF between May and November, 2004[104]. To this regard, it is useful to compare the relative status of the companies which answered the questionnaire against their position according to the TDI. In such context, there results a corporate governance survey index (CGSI), with a positive correlation of 0.58 against 2004 TDI. This preliminary analysis allows verifying the accurate predictive power of the TDI, as an indicator of the degree of commitment to CG good practices shown by publicly-traded non-financial companies.

Institutional Investor Survey

6.21. As a third piece to evaluate CG practices within publicly-traded firms, the CEF conducted a synthetic survey of institutional investors and active participants in the capital market. The survey was designed to identify the perception sustained by the main capital market players on CG within public companies. The principal advantage of this type of measurement is that of capturing the perception of the market about firms' real commitment to the formal principles included in the TDI or the CGSI. Like the TDI and the CGSI, the Institutional Investor Survey (IIS) was structured into five blocks: (i) general principles (considering the degree of firms' adherence to international CG good practices), (ii) senior management and board of directors (analyzing the potential existence of conflict of interest between minority and majority shareholders), (iii) shareholders (focusing on ownership structure and relations between minority and majority shareholders), (iv) provision of information (with a view to assessing the level and quality of publicly-disclosed information), and (v) other company stakeholders (to see whether account is taken of the interests of agents who, without being directly related to the firm, are influenced by actions conducted by the latter.)

6.22. The survey, conducted between August and November 2004, was addressed to institutional investors and key players on the capital market through the Chamber of Retirement and Life Insurance, Association of AFJPs, Argentine Chamber of Mutual Funds and Chamber of Securities Investors of the

[103] The survey is currently under study and no reference shall be made to its results until we may have all publicly-traded firms included in the next measurement.

[104] The survey was emailed and sent by regular mail, together with brief instructions, to the chairman of the board, the general manager and the market relations chief officer of each company. Furthermore, the CEF staff performed thorough monitoring to maximize companies' survey response rate.

Buenos Aires Stock Exchange. The answers covered the top 30 companies in which these fund managers invest assets. It should be stated that these firms have recorded the highest TDI values.

6.23. The survey outcomes show that the perception of institutional investors about CG practices within the firms in which they invest is generally low. Although in relative terms investors' vision tends to coincide with the arrangement predicted by the TDI (the simple correlation coefficient between both indexes is 0.29 for the 30 companies under study), it is worth mentioning that the index is on average lower than the value reflected by the TDI. As it can be seen in Table 12 and Chart 3, the average value between both indexes is significantly different, while the IISI has a relatively more biased distribution toward low values. Table 13, relating to AFJPs' response, shows that in the five (5) questions the percentage of poor and very poor perceptions is never under 70%.

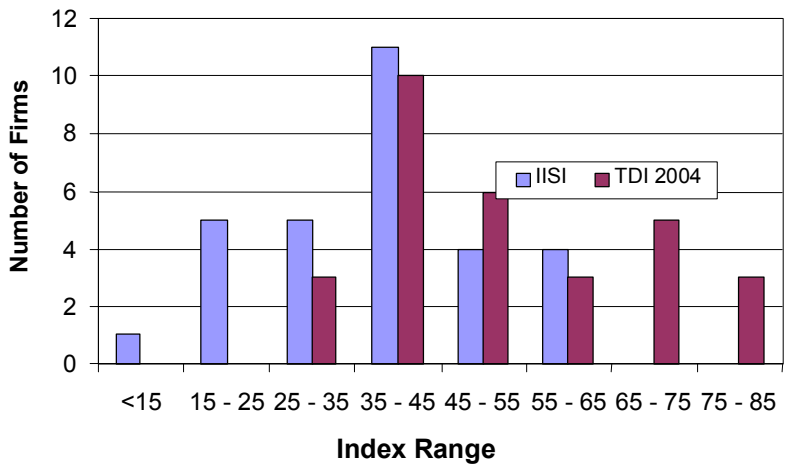
Table 12 - Comparison between IISI and TDI for 30 firms (in %)

Statistics	IISI	TDI
Average	38.56	53.05
Median	40.00	50.00
Mode	40.00	43.21
Maximum	66.67	85.19
Minimum	13.33	30.86
p-value	0.00	

Source: CFS

6.24. Institutional investor perception about CG low level within companies which publicly trade their shares is an aspect worthy of thorough analysis. As we have seen in Table 9, those firms in which AFJPs invest have a CG level (as measured by the TDI) which is significantly higher than the rest of the companies[105]. Paradoxically, the vision of AFJPs themselves about CG within their investee firms is not as encouraging as it would be consistently with the foregoing statement.

Chart 3 - Frequency Distribution between TDI and IISI for 30 firms



[105] Both for TDI 2004 and TDI 2003 and only considering large-sized enterprises to avoid a potential bias due to company size.

6.25. In fact, if we analyze the responses given by the eight AFJPs to the five questions included in the Institutional Investor Survey (see Annex I), we can notice that perception about the priority set by firms in the application of CG good practices is largely unsatisfactory (see Table 13); whereas perception about the degree of independence between senior management and board of directors is largely poor, as it happens with perception about the degree to which minority shareholder rights and interests are protected. On the other hand, the level of transparency in terms of quality, clarity and accessibility of information provided by firms and perception about the relationship between such firms and the remaining stakeholders in terms of social and community involvement initiatives is relatively better, even though it is still unsatisfactory.

Table 13 - Firms' CG in AFJPs' Vision

	Very High	High	Low	Poor	N / A
Question 1: General Principles	3.2	18	46.5	29	3.2
Question 2: Senior Mgmt & Board of Directors	0	11	33	50	6
Question 3: Shareholders	0	13	38	43.1	6
Question 4: Provision of Information	4	25.3	37.8	26.7	6
Question 5: Other Stakeholders	7	20.5	24.2	9.8	38.

Source: CFS (based on IISI)

6.26. Negative institutional investor perception about the degree of board of directors' independence is a revealing piece of information on the absence of a culture promoting effective boards within local companies. The same applies to the negative perception about protection given by firms to minority shareholder interests; all of which enhances the need to improve CG practices, both institutional and contractual. Along such lines, it would be advisable to go forward with legal and regulatory reforms which may allow strengthening the potential role of institutional investors as agents monitoring CG within the firms in which they invest funds under management. For instance, by creating a differentiated market with additional CG requirements and the possibility for institutional investors to invest a larger proportion of their porfolio in companies being CG outperformers.

Relationship Between GC and Economic Performance

6.27. Since CG quality mitigates the inefficiencies entailed by conflicts of interest between the various company stakeholders, it can have a significant impact on company performance. As it has been mentioned before, there is evidence on such CG positive impact that can be found in several international studies (see Section 2 in this Policy Note). These studies focus on accounting indicators (especially, ROA –Return on Assets) and market indicators (such as Tobin's Q, the ratio between market value and replacement value of the firm's assets.) The former indicators show the direct impact of better CG, whereas the latter measure market perception about CG.

6.28. For the first time and for Argentina, we present evidence on this matter below. Table 14 shows the outcome of a ROA regression using as an explanatory variable the TDI, together with other allegedly associated factors, together with CG, and firms' return on assets. The period under study is 2000-2003, which is additionally subdivided into two subperiods (2000-2001, and 2002-2003) to take into account the potential impact of the recent financial crisis. The Table reveals that CG has a positive impact that is highly significant at statistical level. The quantitative impact is very important: studying the results for 2000-2003, an increase of 20 percentage points from the average TDI for the sample would translate into a ROA increase of 2.6 percentage points, i.e., an increase of 1.9 percentage points from the average

figure for the company sample (0.7%.) Reinforcing trust in these estimates, the results appear to be robust vis-à-vis changes occurring in the period under study and the set of additional variables.

Table 14 - Estimated TDI / ROA Ratio

	Dependent Variable: ROA		
	Regression 1	Regression 2	Regression 3
Explanatory Variables			
TDI	**0.0005449**	**0.0004813**	**0.0006292**
	(2.61)**	**(3.13)*****	**(1.79)***
Ln (Age of Firm)	-0.0154112	-0.0209034	-0.0072887
	(-2.11)**	(-2.63)**	(-1.03)
Size of Firm	0.0069701	0.0099801	0.0038725
	(0.54)	(0.327)	(-0.23)
Debt over Assets	-0.0008561	-0.0041904	0.0042438
	(-0.06)	(-0.27)	(0.22)
Sales Growth	0.0000042	-0.00000211	-0.0004995
	(0.12)	(-0.05)	(-0.74)
ADR Issuance	-0.0025899	-0.0032994	-0.0009633
	(-0.41)	(-0.58)	(-0.1)
Industry Sector	0.0015554	-0.0053865	0.008823
	(0.25)	(-1.04)	(0.94)
Public Utilities Sector	-0.0171923	-0.0198887	-0.0135516
	(-1.21)	(-1.25)	(-0.95)
Commodities Sector	-0.0049964	-0.0054604	-0.0069393
	(-0.63)	(-0.73)	(-0.66)
Constant	0.048235	0.0736632	0.0110886
	(1.65)	(2.37)	(0.35)
R Adjusted Square	0.1513	0.309	0.0551
No. of Observations	62	62	59
Statistics F (p-value)	2.51(0.000)	4.35(0.000)	3.72(0.000)
Period	2000-I/2003-IV	2000-I/2001-IV	2002-I/2003-IV

Note:
Statistics t based on robust standard errors
*/**/*** Statistically significant at 10%, 5%, and 1%, respectively

6.29. For their part, Table 15 shows the results from the analysis of the factors determining Tobin's Q value, which captures the vision of the market on the company's future outlook. As it happens in the foregoing case, the TDI shows a robust and positve relationship to the value of Tobin's Q. In both cases, we used control variables to accurately isolate the direct impact between the two variables. In turn, we conducted studies to determine the degree of robustness and we used instrumental variables to exercise control in case there were a potential endogeneity between both variables. All these technical controls enable us to conclude that transparency and disclosure of information has a positive impact on the firm's added value. Both return on assets and value of Tobin's Q show a direct, positive and economically significant relationship to CG index. As mentioned in the conclusions further on, this evidence should seriously be weighted by firms, investors and regulators who, in many cases, believe that in practice CG is not a specifically meaningful topic in Argentina.

Table 15 – Estimated TDI / Tobin's Q Ratio

Dependent Variable: Q

	Regression 1	Regression2	Regression3
Explanatory Variables			
TDI	**0.0059**	**0.0054**	**0.0051**
	(2.27)**	**(2.73)*****	**(2.1)****
Ln (Age of Firm)	0.033	-0.065	-0.0078
	(0.33)	(-1.71)*	(-0.1)
Size of Firm	0.2215	0.2567	0.2455
	(2.11)**	(3.28)***	(2.62)**
Debt over Assets	0.4503	0.6344	0.6112
	(1.72)*	(3.01)***	(1.98)*
Sales Growth	0.0008	0.0002	-0.0291
	(0.74)	(0.32)	(-4.36)***
ADR Issuance	-0.0387	0.0036	-0.0179
	(-0.42)	(0.05)	(-0.21)
Industry Sector	0.1298	-0.0184	0.2895
	(1.59)	(-0.25)	(2.78)***
Public Utilities Sector	0.0997	-0.0471	0.0802
	(0.56)	(-0.53)	(0.65)
Commodities Sector	0.1634	-0.076	0.3224
	(1.13)	(-0.9)	(3.25)***
Constant	0.2776	0.6843	0.391
	(0.62)	(3.69)***	(1.21)
R Adjusted Square	0.0448	0.3784	0.247
No. of Observations	54	53	50
Period	2000-I/2003-IV	2000-I/2001-IV	2002-I/2003-IV

Note:
*/**/*** Statistically significant at 10%, 5%, and 1%, respectively.

7. Diagnosis

Based on the analysis and evidence presented in this Policy Note, we can make the following diagnosis:

7.1. International evidence, as well as Argentine case evidence produced by the CEF, show uncontestable arguments about the importance of CG good practices. Compliance with good practices adds value to companies and facilates better access to financing, while at the same time creates a beneficial impact on the development of financial services and economic growth. International trends show that, despite extensive disclosure of self-regulatory codes, most countries have advanced toward legal and/or regulatory reforms enhanced with an adequate degree of required enforcement to guarantee compliance with laws and regulations.

7.2. Empirical evidence and legal, regulatory and institutional framework analysis show that Argentina is affected by a clearly deficient structure of CG both institutional (legal requirements) and contractual (non-binding practices). There is no adequate interest and knowledge on the part of corporations, investors, securities markets and regulatory bodies about the advantages of CG good practices.

7.3. In relation to the legal framework, there is a positive vision regarding the principles enshrined by Executive Order 677/01, even though there is leeway for executing improvements, particularly in matters concerning structural capital market issues, mainly as regards the mutualist model of organization.

7.4. In relation to the regulatory framework, evidence shows that there is a partial adoption of the above-mentioned principles. In some topics, there is a noticeable lack of regulation on aspects included in the legal rule, whereas in other cases regulation is not specific enough, leaving the degree of compliance to the discretion of companies. A clear example of this circumstance is the absence of regulation on the extended annual report which requires that issuers disclose material information to investors but, as there is no specific regulation thereon, the current framework fails to help improve the level of public disclosure to issuers.

7.5. On companies' side compliance is merely formal, relevant and qualitative information is scarce and strictly confined to minimum requirements set to avoid sanctions by the regulator, and the level of transparency and disclosure is clearly unsatisfactory. In the last years, improvements in good practices generally related to regulatory changes, rather than voluntary initiatives. This scarse adherence to best practices is largely based on the lack of incentives in that regard, mainly the absence of a primary market for share and bond issues which may allow capitalizing investment in CG improvement. Of course, in addition to this factor, there is a predictable resistance of directors and controlling shareholders (*insiders*) to abandon the private benefits of control, a still insufficient understanding of the benefits linked to good CG, and the inaction of minority shareholders to exercise their rights.

7.6. The absence of independent and effective Boards of Directors is one of the main pieces of evidence on the empirical analysis deriving from the CEF study and it confirms the negative perception of institutional investors about this issue. The culture of independent and effective boards is a core and essential component of the recent reforms and recommendations on CG best practices. Although the improvements introduced by Executive Order 677/01 have helped upgrade the operation of boards within publicly-traded non-financial companies (e.g., the institute of "independent director", the modulation of director liability, the mandatory formation of an audit committee, etc.), effective operation as well as true independence are aspects pertaining to contractual CG and company-based practices.

7.7. Effective enforcement is another aspect which shows a remarkable weakness. On the one hand, there is a noticeable deficiency in the number of financial and human resources available to the regulator, as well as in regulator independence from political power, in addition to the lack of priority given to the strengthening of CG. Likewise, it is required that more zeal be applied to the enforcement of some current CG standards -initially at least those which are cost effective for companies but may have a potential

strong impact on the market. In self-regulatory markets, arbitration mechanisms have been established but they are not commonly used, largely because securities markets are not familiar with them or fail to disclose their existence and, on the other hand, because their potential users are doubtful about the effectiveness of arbitration procedures. The Institutional Investor Survey (IIS) reveals several important aspects, inter alia, the perception that minority shareholder rights are not protected in practice.

7.8. According to the surveys conducted by the CEF, institutional investors believe that companies fail to comply with CG best practices. At the same time, there are no suitable incentives for them to weigh good CG as a key aspect in their portfolio selection policies.

7.9. The foregoing situation contrasts with international experience, which shows that institutional investors strongly appreciate the aspects relating to CG best practices when they choose to allocate their investments and, at the same time, play an active role within companies.

8. Policy Recommendations

Considering the importance of the adoption of CG good practices for companies as well as for financial intermediaries, financial services and economic growth, the recommendations deriving from this Policy Note and the foregoing diagnosis, which were enhanced by the comments received in the context of the Round Table Meetings on CG held at the CEF in March-April, 2005 are described below.

8.1. It is advisable to advance in the design of a set of uniform and mandatory requirements for all publicly-traded non-financial companies (institutional CG) in line with international standards and good practices. This framework should also extend to banking and non-banking financial institutions acting as intermediaries of third-party funds[106]. However, it should be considered that optimal balance between binding and non-binding components entail a great complexity. It is clear that institutional CG should not completely replace contractual CG, and viceversa. Generally, institutional CG plays an irreplaceable role in aspects such as ensuring a minimum block of uniform public information comparable among all firms; modulating a liability regime for directors and controlling shareholders (*insiders*) which would be aligned with the objective of creating value in the firm; clearly establishing minority shareholder and creditor rights and effective enforcement of such rights and actions by providers of financing to the firm. For its part, contractual CG should derive from a private cost-benefit analysis. Disclosure and adoption of Codes of Good Practices[107] is an interesting contribution but it may not be sufficient, as shown by recent international experience[108].

8.2. It is necessary to place in the agenda the importance of improving CG. Along this line, it is important to underscore private-sector efforts made by companies, foundations, universities, business chambers and securities markets. Additionally, the lack of adequate interest in terms of transparency and good CG should occupy a key position in the public agenda, taking into account that CG improvements would have major social benefits. In fact, it is advisable to avoid the historic vicious circle which prevents companies from improving their CG faced with the scarce capital market depth which, in turn, perpetuates itself due to the absence of investors as a result of the weak CG practices implemented by companies. Action taken by the public and private sector alike would facilitate breaking such vicious circle. In the public sector case, it should be convenient to discuss low or zero tax cost-based alternatives to stimulate the strengthening of CG for the company universe, supplementing such efforts with an outreach campaign on financial education about CG advantages, drawbacks and international trends. In the private sector case, it is advisable to eliminate certain unjustified prejudices (e.g., that CG is a relevant topic only for large companies from industrialized countries, that any CG improvement is very costly and it implies no tangible benefit for shareholders, etc.) and to become more aware of the medium and long term benefits (investment in CG, like other investments, has a certain ripening period.) On the other hand, CG may favor not only the issuance of shares but also the access to banking and non-banking indebtedness. This Policy Note precisely seeks to encourage this awareness process by offering not only conceptual arguments but also tangible evidence on the positive impact of CG on the profitability of companies and their dividend policies.

8.3. In relation to the legal framework, the design of a new institutional CG framework should not necessarily imply full alignment with the CG standards in the most advanced countries. It should be taken into account that, in the short term, the market will not offer clear natural incentives to improving CG (such as greater access and better financing conditions via the capital market.) One of the pending aspects relates to structural issues that have to do with capital market organization, such as direct supervision over

[106] Although in these cases the focus would be placed on minority shareholders, rather than creditors, many CG practices (particularly those concerning information disclosure as well as formation and operation of the Board of Directors and Management) are common to companies that may be either publicly traded or closely held, and which may conduct financial or non-financial activities.)

[107] There is an initiative for a Code of Good Practices by IAGO-KPMG and IDEA.

[108] There is also a risk that the adoption of these Codes respond to an institutional relations and marketing strategy implemented by companies, rather than a genuine commitment to CG improvement.

market intermediaries and allocation of economic resources and legal guarantees for the financial regulator's independence. The inclusion of the guiding principles of Executive Order 677/01 in a draft amendment to the Companies Act is a highly important matter that should be open to public discussion. So far, the partial adoption of the principles enshrined by Executive Order 677/01 has suggested that the enactment of statutory rules is not enough to cure CG deficiencies.

8.4. In relation to regulation, it would be necessary to have a more detailed regulation on reporting requirements to be met by firms in order to reduce discretion and dispersion in the disclosure of material public information. Initially, attention should be given to those issues which imply cost-effective compliance for companies and may have a high impact on the protection of minority shareholders, as well as disclosure of information on board and senior management structure and procedures, both past and future dividend policy, board and senior management remuneration policy (in these cases, with a justification for the adopted criteria), and the complete ownership structure of firms. Although Executive Order 677 deals with these matters generally, the lack of CNV regulation and the weak enforcement of such order are reflected in a low degree of transparency and compliance therewith.

8.5. With a view to enhancing transparency and generating incentives for the voluntary adoption of commitments in terms of CG, it would be advisable to create a special listing segment for companies deciding to adopt CG best practices. The Brazilian *Novo Mercado* is a leading case in this regard (see Box 1). This should be supplemented with regulatory changes that may be attractive for institutional investors to invest in companies listed in such special segments.

8.6. In relation to the operation of independent and effective boards, from the standpoint of institutional CG and in the context of company law, it would be appropriate to improve the liability regime for directors in line with the objective of creating firm value, especially in publicly-traded non-financial companies, bearing in mind the supervisory role played by the boards in such firms and reducing joint and several liability whenever there are special committees (horizontal distribution of competencies) and/or specific empowerment to a delegate director or management (vertical distribution of competencies). The proposed leniency policy for minor negligence or error in business judgment and severity policy for breach of fiduciary duties (private benefits of directors and controlling shareholders), together with a special modulation of liability in case of insolvency that increases the liability of directors who fail to take action faced with the firm's insolvency (*wrongful trading rule*) and creates duties of loyalty to creditors (*fiduciary duties*), are all proposals designed for such purpose. A liability regime is appropriate to create value whenever it is capable of attracting the most qualified individuals to senior positions within those firms that are liable for creating social value in a capitalist model. From a contractual CG viewpoint, it is essential to encourage a "culture of effective boards" by promoting codes or principles of good goverance which may clarify the board core duties that are not subject to delegation, the manner of selecting and recruiting directors, the formal board composition and operation (e.g., disclosure of the board's operational rules), including the role and competency of key board committees, and a suitable balance of power within the board.

8.7. In relation to effective enforcement, it would be advisable to take the necessary measures to provide the regulatory body with independence and adequate resources for monitoring firms' proper compliance with legal and regulatory rules and impose sanctions if need be. Additionally, it should be required to review self-regulation mechanisms on the capital market and the mutualist model of organization, which do not seem to act in favor of better CG. Emphasis should be laid on the application of rules that are cost effective for companies but may have a strong impact on the market. It should also be encouraged the application of arbitration mechanisms. Likewise, in order to promote an active role on the part of financial institutions, good CG within such entities must be a prerequisite, even though a more active role played by them would require some regulatory changes. Additionally, a more active role by reputational intermediaries (*gatekeepers*) may require the adoption of auditing and accounting standards closer to best practices. The adoption of ethical standards in business practices should be enhanced with suitable regulatory incentives.

8.8. For their part, institutional investors should assume a more active role in claiming good CG, interacting more strongly with their own companies and regulatory bodies alike. The scarce attention paid to CG by such investors gives account for the lack of incentives in this regard. In the case of AFJPs, it is recommended that changes be introduced in the regulations concerning management fees, investment policies and participation of pension funds as minority shareholders in business firms. The latter aspect should also include insurance companies and mutual funds. The creation of premium listing segments on the equity and bond market would contribute to create an appropriate incentive.

8.9. Bearing in mind the increasing capital market globalization, the key role of international institutional investors and the emphasis laid by them on the monitoring and control of CG best practices, regulators as well as market participants must weigh the need to adapt themselves to mininim CG standards so as to ensure that such institutional investors may have easier access to domestic financial market. Enhanced institutional investor market participation would also generate significant and positive externalities for the development of financial services.

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ANNEX I - Institutional Investor Survey

1- On General Principles:
There is growing international consensus as to the fact that CG good practices significantly increase firms' market value and facilitate access to financing.
Which is your perception about the priority set by the firm in connection with the application of CG good practices?

☐ Very High ☐ High ☐ Low ☐ Poor ☐ N/A

2 - On Senior Management and Board of Directors
There is a potential conflict of interest between shareholders (equity providers) and management (equity managers) that may lead them to act as free riders. For such reason, it is important to exercise effective control over decisions made by managers on behalf of the Board of Directors in its capacity as representative of shareholders.
Which is your perception about the degree of independence existing between senior management and board of directors?

☐ Very High ☐ High ☐ Low ☐ Poor ☐ N/A

3 - On Shareholders
There may be a conflict of interest between majority and minority shareholders. In those cases in which minority shareholder rights are not duly protected, controlling shareholders may use their power for its own benefit in the manner known as private benefits of control or expropriation.
Which is your perception about the degree of protection granted to minority shareholder rights and interests?

☐ Very High ☐ High ☐ Low ☐ Poor ☐ N/A

4 - On Provision of Information
With a view to mitigating the information problems suffered by minority shareholders, it is important that the company disclose as much information as posible on a clear, complete and accurate basis.
How do you rate transparency in terms of quality, clarity and accessibility of the information provided by the firm?

☐ Very High ☐ High ☐ Low ☐ Poor ☐ N/A

5 - On Other Stakeholders
CG good practices require consideration of the interests of agents who, without having a direct interest in the firm, are influenced by actions taken by the company (customers, vendors, the community at large, etc.)
Which is your perception about the relationship between the firm and society? (Social and community initiatives.)

☐ Very High ☐ High ☐ Low ☐ Poor ☐ N/A

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