



CORPORATE GOVERNANCE IN BRAZIL:  
A STUDY ON 647 OPEN CORPORATIONS

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**Abstract**

This article draws on a sample of 647 Brazilian publicly traded corporations to explore some of the features of corporate governance in this country. The results that due to the size of the sample (80% of total population) are particularly reliable, show that ownership concentration is by far the mostly used governance mechanism what matches the patterns observed in Continental European countries. Results also raise doubts about the real role boards of directors play in Brazilian open corporations, what offers new streams for researchers willing to tackle issues in emerging economies.

**Keywords:** corporate governance; voting rights; ownership structure; boards of directors

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**1. Introduction**

The objective of this article is to report results over mechanisms of governance currently in use by Brazilian open corporations, namely board composition, the concentration of share ownership and the issuing of shares with voting rights. The choice of the mechanisms is supported by the definition of corporate governance in section 2.

Brazilian institutions concerning corporate matters fit what is later in this article defined as “continental european system” and are clearly related to La Porta, Lopes-de-Silanes, Shleifer and Vishny(1997). In a study that covered 49 countries, these authors present evidences of a correlation between the size of the capital-markets and the level of investors protection — measured by both the character of legal rules and the quality of law enforcement. Countries in which French civil law prevails have weaker investors protection and a

narrower capital market than “common law countries”, like United States and United Kingdom, for example.

Needless to say that Brazil is among the first group. While english speaking countries boast 35.5 open corporation per million inhabitants, Brazil has a ratio of only 3.48.

The number of IPOs in those countries is 2.23 per million citizens per year and in Brazil it's near zero. Finally another striking number is the ratio of GNP of shares owned by minorities share holders; while in anglo-saxon economies minorities hold equivalent to 60% of GNP, in Brazil, non-controlling owners hold no more than equivalent to 18% of GNP.

It sight of these findings it becomes very clear the relevance of the live debates currently being carried on in Brazilian parliament concerning changes in the rules over open corporations and minorities right and should a bill currently in

discussion in congress pass, minorities will be granted

This whole situation might give the impression that open corporations play so minor a role in Brazil that look up their corporate governance is not import. Wrong conclusion The struggle of countries to draw foreign capital into their own economies is getting tougher and tougher and equity funding is likely a way for countries that face endemic lack of capital. In this context corporate governance is a growing demand of, e.g., financial institutions such as pension funds and private equity firms.

Brazil is definitely one of these countries and the path to improved corporate governance starts with the knowledge as clear as possible of the current situation, thus the importance of research on the subject.

While many scholars have worked on the causality involved in corporate governance — some of which are reviewed in section 3 — Brazilian research on the theme is so incipient that a closer look at the state of affairs is still number one in the agenda, therefore articles such as this are needed.

This article is structured as follows. Section 2 presents concepts of corporate governance that support the research. Section 3 quickly reviews the recent empirical literature on the issue. Section 4 presents the data and section 5 comments on them.

## 2. Concepts, Systems and Mechanisms

First of all, it is important to define what corporate governance is the article referring to. One essential element about that concept is whether should it see the shareholders as the exclusive owners of rights to be safeguarded or should other constituencies also be included.

Lately, some authors have offered alternatives to address the doubt and it's interesting to verify some consensus being accomplished. The first contribution comes from Germany, Shimidt(1997:4):

Corporate governance is the totality of the institutional and organizational mechanisms, and the corresponding decision-making, intervention and control rights, which serve to resolve conflicts of interest between various groups which have stakes in a firm and which either in isolation or in their interaction, determine how important decisions are taken in a firm, and ultimately also determine which decisions are taken.

Another one has been written by americans John and Senbet(1998:372):

Corporate governance deals with mechanisms by which stakeholders of a corporation exercise control over corporate insiders and management such that their interests are protected. The stakeholders of a corporation include equity-holders, creditors and other claimants who supply capital, as well as other stakeholders such as employees, consumers, suppliers and the government. The professional

managers, the entrepreneur, and other corporate insiders control the key decisions of the corporation.

Finally, one coming all the way from China, Xu and Wang(1999:76):

In light of the financial crises in East Asia, it is timely and crucial to study issues related to corporate governance, generally defined as institutional arrangements and mechanisms through which outside investors in the firm control the insiders of the firm to ensure returns on their investment.

As it had been pointed out, regardless of their different origins, the three definitions converge in considering other constituencies as well as shareholders as owners of rights to interfere in the governance of corporations. More than assigning them with rights, actually the definitions imply that other constituencies do play a role whether *ex-ante* contracted or *ex-post* begotten.

The definition says governance is a set of mechanisms, so it is also necessary to present the known mechanisms but before this it is also important to name the types of mechanisms, or as they are more commonly referred to, the systems of governance.

The different systems reflect the debate over the concept of corporate governance and the debate is not new, says Clarke(1998:181):

Just as economies go through cycles, so do economic ideas. The concept of stakeholding has recently become popular in the United States and the United Kingdom, but has experienced cycles of interest for much of this century. For many years stakeholder institutions and practices have been firmly established in north European economies such as Germany and Scandinavia, and in Asian economies, particularly Japan. But as the Anglo Saxon economies begin to see the attractions of stakeholding, Germany and Japan have fallen under the spell of shareholder value.

This statement seems to be backed up by other authors such as Xu and Wang(1999:76), "it's well known that there are two different models in corporate governance, the Anglo-American and the German-Japanese model" and still Rock(1996:367) for whom, "in the last few years, comparative corporate governance — German and Japanese in particular — has been a hot topic in U.S. law reviews and conferences".

But what mechanisms do these three systems provide?

German corporate governance is said to be bank-centered: universal banks serve as lenders shareholders, investment fund managers, investment bankers and supervisory board members. Japanese governance is also considered bank-centered but with the addition of cross share-holdings among a group of corporations that, because shareholdings offer parallel intra-group product sales, provide an additional monitoring mechanism. In both, German and Japanese systems, institutions such as the hostile

market for corporate control is considered practically non-existent.

Now to the Anglo-Saxon system. The three most important types of mechanism in this market-centered system are the following.

1. Market for control and its correlated anti-takeover provisions like poison pills, blank check preferred stock, stakeholder clause, among others<sup>1</sup>. The market for control is said to place pressure on managers or otherwise be taken over in pursuit of alignment by shareholders.

2. Ownership structure, or as Romano(1996:277) calls it “block ownership or relational investing” a monitoring-inducing level of stakes possessed by a single group of shareholders.

3. Boards of directors, the committee of last resort decision makers assigned by the shareholders to according to Fama and Jensen(1983), “ratiocify and monitor” decisions on their behalf. Williamson(1985) states that the board of directors is the main governance mechanism for shareholders. Others like U.S.’s National Association of Corporate Directors, NACD, propose that boards be made up mostly of outsiders and that board practices reinforce this independence like regular evaluation of board members and limiting reelection permission.

But what are the mechanisms currently in use in Brazil? Do they match any of these models? To offer some input in to these questions is the objective of this article but first it is timely to review some of the empirical literature concerning corporate governance.

### 3. Literature

Corporate governance has lately become an attractive subject and many hypothesize the causality between governance mechanisms and corporate objectives such as level of output, profitability and market value.

As seen above, the discussion has taken place in countries as different as United States, Germany, Japan and even China. The importance of the issue was stepped up in the United States after what Gilson(1996:327) refers to as “the turmoil of the 1980s”. The same author goes on to say that “until the 1980s, corporate governance was largely the province of lawyers” this meaning that most attention to the topic had mainly a legal perspective but the rise and fall of the market of corporate control<sup>2</sup> in that country made it an important subject for economists as well.

<sup>1</sup> For a complete review of the legal provisions see Danielson and Karpoff(1998:349).

<sup>2</sup> Jensen(1993:832) reports that “In the 1980s, the capital markets helped eliminate excess capacity through several leveraged acquisitions, stock buybacks, hostile takeovers, leveraged buyouts and divisional sales...was followed by public policy changes... that restricted the market for corporate control”.

In fact, the issue of corporate governance has received ever greater awareness since the 1980s but it’s not something new. Back in 1932, it had already been fairly sketched by Berle and Means(1932) and their concern over the separation of ownership and control. Their argument was roughly as follows:

The dispersed holdings of stock across a multitude of small investors had created an effective separation of ownership and control, with no individual stockholder having any real incentive to monitor managers and ensure that the officers and board were running the firm in the owners’ interests. Milgrom and Roberts(1992).

That situation was called by Chandler(1977) as “managerial capitalism” and according to Hawley and Williams(1997) the separation “would come to dominate most thinking about issues of corporate governance for much of the rest of the century”; or as in the words of Gilson(1996:331):

Thus, for the next sixty years, the intellectual mission of American corporate governance took the form of a search for the organizational Holy Grail, a technique that bridged the separation of ownership and control by aligning the interests of shareholders and managers.

Another development has brought about some important changes in that scenario. Hawley and Williams(1997) highlight the concentration of stock ownership in the hands of “financial institutions, notably public and private pension funds and mutual funds”, a transformation that Drucker(1979) had already named as “The Unseen Revolution”. The authors maintain that by 1994 no less than 57% of the outstanding equity of the 1000 largest US corporations were collectively held by these institutions, thus the statement that a new system was in place: “fiduciary capitalism”.

Therefore generally speaking, two features currently shape American capitalism, the reliance on governance mechanisms other than the market for corporate control and the concentration of ownership in the hands of financial institutions. The state of German and Japanese models have already been analysed in section 3.

Still, the standing question is “does governance matter?”

A survey by McKinsey covering 200 institutional investors managing approximately 3,25 trillion dollars in assets worldwide shows that 80% of these fabulous decision makers are willing to pay an average of 21,8% premium for shares of companies boasting corporate governance institutions in detriment or companies with the same financial performance but lacking an independent board of directors, transparency on decision making and regular evaluation of board members.

But “willingness” is not the same thing as effective purchase and Gilson’s(1996:328) warning still holds: “the existence of an important link between corporate governance and corporate

performance is not self evident; rather it is a hypothesis and not a revealed truth"; for example, Gorton and Schmid(1999) look at the Austrian cooperative banking industry and find evidence that where the separation of ownership and control is greater, firm performance decreases and. Xu and Wang(1999) find signs that profitability of publicly listed companies in China are positively related to ownership concentration and ownership composition, to mention two recent studies.

Actually, the causality hypothesis goes in both ways, thus besides the many works that seek the relationship between governance and efficiency, there are also those that endogenize those mechanisms.

Taylor and Whittre(1998) find that Australian open companies in which specific human capital is needed governance mechanisms tend to hand more control over to internals than to externals through the issuing of dual class voting. Drawing on the case of airline industry, Kole and Lehn(1999) suggest that

governance mechanisms evolve in response to deregulation bringing about concentration in ownership, significant increase in CEO pay and decrease in board composition.

It is time now to look at corporate governance in Brazil.

#### 4. Data and Results

The data belong to a sample provided by Comissão de Valores Mobiliários (CVM) the Brazilian counterpart to U.S.'s Securities and Exchange Commission (SEC).

The sample is made up of 647 open corporations and refers to the year 1996 financial report open corporations are yearly obliged to present to CVM. Much of the value offered by this study stems from the size of this sample, 80% of the standing population.

**Table 1.** Board Composition Descriptive Statistics

	mean	trimmed mean	median	variance	standard deviation
Non-shareholder employees	0.166631	0.136708	0.000000	0.052324	0.228773
Shareholder-employees	0.128396	0.106968	0.000000	0.03848	0.19161
Non-shareholder-outsiders	0.553369	0.559299	0.67000	0.09376	0.306204
Shareholder-outsiders	0.151329	0.122352	0.00000	0.05634	0.237359
board size	5.82	5.46	5.00	14.706	3.83

In many articles, board composition is proxied as insiders & outsiders or as insiders & independent members. It is not rare either that a third category is added "intermediate", outsiders that still bear some relationship to management. In the studied sample there is a different type of third category, insiders with shares and if it wasn't for a specificity of the Brazilian situation, the level of independence would very much meet NACD recommendations as in section 2. But most of the non-shareholder outsiders are "independent of sorts", so to speak. They are mostly *ad-hoc* taken and given one share in order to have a seat in the board, as that is a legal requirement.

**Table 2.** Comparison mean & trimmed mean

	non-shareholder employees	shareholder employees	non-shareholder outsiders	shareholder outsiders	board size
mean	16,66%	12,83%	55,34%	15,13%	5,82
trimmed mean	13,67%	10,70%	55,93%	12,23%	5,46
differences	-17,94%	-16,60%	1,066%	-19,17%	-6,18%

The category with smallest data dispersion is the non-shareholders outsiders. This can easily support the formulation of hypotheses surrounding the causes to such a standardized behavior.

**Table 3.** Descriptive Statistics Other Governance Mechanisms

	mean	trimmed mean	median	variance	standard deviation
% share with voting rights	0.5537657	0.55973968	0.50000000	0.109	0.3299147985
Ownership concentration	0.8808084	0.91849092	0.996296250	0.05935	0.2436223414

Percentage of shares with voting rights express the willingness controlling parties have to share control with other shareholders and ownership concentration is the ultimate.

**Table 4.** Comparison mean & trimmed mean

variável	difference
percentage in share with voting rights	1%
Ownership concentration	4,2%

The comparison shows a low level of data dispersion around the mean what adds to the ability mean has to represent the sample in both cases.

## 5. Comments

Ownership concentration in Brazilian open corporations is huge. In average, controlling interests own 88% of all shares issued, irrespective of industry or nature of control — state, foreign or private. By the way, private corporations make up the bulk in the sample, 85.9% with state-controlled as 10.1% and foreign companies 3.9%. This alone speaks a lot about the patterns in funding within the country. Studies like La Roca apud Folha de São Paulo (1998) advocate that the level of interest rate and the tax-burden in Brazil still make it prohibitive to multinationals to launch their IPOs.

Nevertheless, this level of ownership concentration resembles La Porta, Lopes-de-Silanes and Shleifer(1998) whose 27 countries study finds that where minorities rights are less protected either families or the State — mainly through the pyramid scheme — ultimately possess controlling stakes in the firms.

The issuing of voting rights doesn't seem to be a major governance mechanism among Brazilian corporations. Contrary to common sense, 459 of the 647 analysed companies have issued more than 50% of share carrying voting rights — *ações ordinárias*. The average percentage is 55.3% of shares with the right to vote issued per company.

Finally, board composition is by far the less likely device to be regarded as a governance mechanism. In average, 71.9% of board members per company are non-shareholders.

Actually, these normally hold one share only, literally. Companies are said to do this in order to comply with the rule — *Lei das SAs* — which imposes every board member has to own shares.

This pattern of board composition raises some hypotheses. Are boards just “put together” in order to meet the rule that says every corporation has to have a board? Are those non-share holders mostly owners' relatives given a seat in the board in order to put up with family pressure or again to formally obey the law? Are boards a tool to so to speak coopt the environment and as a byproduct create income for its members?

Definitely it's quite difficult to consider a board that so much lacks share holders as a control device. Another important aspect is raised by the non-negligible presence of employees. According to data, in average 29.4% of board members belong to the hierarchy, in other words are subject to the CEO

authority. This is an indicator that doesn't fit very well in the “best practices” codes.

The article's conclusion is that share ownership is still the most important of all governance mechanisms currently in use in Brazil. Also Brazilian institutions of governance seem much more in line with those of continental Europe and do not meet the prescriptions of the stakeholder corporation but a soaring pension funds participation might lead the country closer to the fiduciary capitalism as in the U.S.

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