

VALUE, GOVERNANCE AND FOREIGN SHAREHOLDING IN BRAZILIAN COMPANIES

Natalia Simoes * Andre Carvalho**

* Getulio Vargas Foundation

** Federal University of Rio de Janeiro, The second author would like to acknowledge and thank support from CNPq and FAPERJ.

Abstract

This study aims to identify the characteristics of Brazilian listed companies that have foreign investors. The purpose is to examine whether such companies have higher performance and valuation and better corporate governance. We study 215 listed companies from 2001 to 2012, and find that there is a significant relationship between the presence of foreign investors and higher firm valuation, higher profitability and better corporate governance.

Keywords: Foreign Investors, Corporate Governance, Firm Value And Performance

1. INTRODUCTION

The relationship between corporate governance, value and performance of the firms is the subject of numerous studies, which in general conclude that there is a positive correlation between governance and higher firm value and profitability. In the finance literature there are also studies on the relationship between the presence of foreigners in the capital of a firm and valuation, profitability and corporate governance practices. Foreign capital can encourage and finance economic growth in emerging countries and allow developed countries to diversify their investments better.

Berle and Means (1932), analyzing the ownership structure of companies in the US, find the prevalence of public companies with dispersed ownership among several small minority shareholders. There are few countries that have companies with diffuse ownership and, in general, this structure occurs in large corporations of Anglo-Saxon legal tradition of countries.

La Porta et al. (1998) show a strong negative correlation between the concentration of ownership and quality of legal protection to investors in a given country. In countries where the law does not adequately protect investors, they must have stakes large enough to carry out the monitoring of the company's management. Brazil, which belongs to the tradition of French law, offers less protection to investors and so it is expected high concentration of capital in the companies, especially as regards the voting capital (La Porta et al, 1998).

Pohl, Claessens and Djankov (1997) conclude that, in the Czech Republic, the higher the ownership concentration the greater the profitability and valuation of companies, since there is greater incentive to monitor companies and implement the necessary changes and improvements. The authors also show that the presence of foreign investors is positively related to profitability and negatively related to Tobin Q.

Kim and Kang (2008) argue that multinationals have specific advantages (superior management skills, improved production technology and more solid financial position) compared to domestic firms, and it should be expected that foreign investors take more active role in corporate governance. On the

other hand, if foreign investors have less information on domestic companies, and since there is a cost disadvantage associated with this information (cost of obtaining information, travel costs, etc.), the incentives to engage in governance activities are lower than domestic investors.

A factor that can limit the presence of foreign investors is the distance between them and the target company. Several studies show that, in the United States, investors that are located near the investee company have information advantage, possibly due to easier access to the company's valuable information (Coval and Moskowitz (1999)). King and Kang (2008) show that, in the United States, foreign investors located in the same state of investee companies are more likely to engage in corporate governance activities than investors in other states.

Grinblatt and Keloharju (2001) analyze Finnish companies and suggest that the preference for investments in domestic companies is due to greater familiarity, which can be divided into three aspects: the spoken language, culture and distance of the investor to the investee company. The study shows that Finnish investors whose mother tongue is Swedish are more likely to buy shares of companies whose President speak Swedish. Since the difference in the spoken language can create major barrier in the communication process, the study suggests that the mother tongue is a major source of asymmetries in foreign purchases. Another conclusion is that companies domiciled in Finland who publish their annual reports in Finnish and Swedish have a considerably larger shareholder base.

Chan, Covrig and Ng (2005) show that capital controls, accounting standards, regional laws, rating and GDP growth are factors that influence the decision to invest abroad. Caramico, War and Gasparelo (2011) study the behavior of stock markets in countries that get investment grade, and show that, in the 20 months prior to obtaining investment grade, there is a strong inflow of funds.

Gillian and Starks (2003) find that an important factor in the development of corporate governance in some countries is the presence of foreign institutional investors as shareholders of the companies. On the one hand, firms may be motivated to improve their governance practices to

attract foreign capital, but on the other, the increase in investment from foreign institutions can provide power to these institutions to enforce the changes in governance.

Since the 1990's, the Brazilian market has been gradually allowing the entry of foreign funds. The size of foreign investment in Brazil increased a lot in the last two decades, especially after receiving investment grade status by Standard & Poor's in 2008, followed by Fitch and Moody's.

The favorable environment, combined with a lower risk perception in the Brazilian economy, generated a greater flow of capital to the markets and companies in various industries. From 1995 to 2006, foreign direct investment (FDI) in Brazil grew 14.1% per annum, and, after obtaining the investment grade, the growth rate rose to 19.3% per annum from 2007 to 2013. According to data from Central Bank of Brazil, the share of FDI in Brazil's external liabilities increased from 37% in 2002 to 69% in 2013. The stock of FDI in Brazil in relation to total world increased from 1.6% in 2000 to 3.3% in 2011.

In Brazil, Silveira, Barros and Fama (2004) concluded that the identity of the controlling shareholder does not appear to have an impact on the level of corporate governance and reinforced the idea that corporate governance is probably determined endogenously from observable characteristics of the company.

This paper studies the characteristics of companies that have foreign shareholders in its capital, and analyzes the relationship between the presence of foreign shareholders, firm performance, valuation and governance practices. We estimate panel regressions to examine whether the financial

and market indicators of foreign-controlled companies are better than those of companies in which the largest shareholder is Brazilian. Our results indicate that companies with foreign shareholders have higher performance, valuation and better governance practices when compared to domestic companies.

2. DATA AND METHODOLOGY

Our sample is comprised of 215 listed firms listed from 2001 to 2012. The ownership and governance data come from the Brazilian Securities and Exchange Commission's website, and the financial and accounting data come from Economatica and Bloomberg databases.

First, we collect the information on the largest shareholder with voting rights in each company and classify him as Brazilian or foreigner. Then we split our sample into two groups according to the presence of foreign shareholders or not. We perform statistical tests to analyze if firm characteristics are significantly different between the two groups of companies.

To assess whether companies with foreign shareholders have higher value, we estimate panel regressions using the price-to-book and Tobin's Q as dependent variables. Our variable of interest is the presence of foreign controlling shareholders, so we create a dummy variable to identify them. As control variables we use various financial and governance data identified as determinants of firm value in previous studies. The estimated models are as follows:

$$P/B_{i,t} = \beta_1 + \beta_2 For_{i,t} + \beta_3 ForVOT_{i,t} + \beta_4 SIZE_{i,t} + \beta_5 LEV_{i,t} + \beta_6 ROE_{i,t} + \beta_7 NM_{i,t} + \beta_8 Vot_{i,t} + \epsilon_{i,t} \quad (1)$$

$$Q_{i,t} = \beta_1 + \beta_2 For_{i,t} + \beta_3 ForVOT_{i,t} + \beta_4 SIZE_{i,t} + \beta_5 LEV_{i,t} + \beta_6 ROE_{i,t} + \beta_7 NM_{i,t} + \beta_8 Vot_{i,t} + \epsilon_{i,t} \quad (2)$$

where P/B is the price-to-book (ratio of market value to capital stock value), Q is the Tobin's Q (ratio of market value of assets to book value of assets), ROE is the return on equity (net income/shareholder's equity), NM is a dummy variable equal to 1 when a firm is listed on New Market, For is a dummy variable equal to 1 when a firm has foreign controlling shareholders, $ForVot$ is the voting capital of the foreign shareholder, Vot is the voting capital of the largest shareholder, $Size$ is firm size (log of total assets), and Lev is leverage (liabilities/total assets).

3. RESULTS

Table 1 shows the descriptive statistics of the variables used in the study from 2001 to 2012. Around 11% of listed companies have foreign shareholders in their capital. On average, companies have price-to-book of 2.06, Tobin's Q of 1.70, ROE of 5.77%, and leverage of 60%. The largest shareholder owns on average 55.1% of the voting capital, and 21% of the companies are listed on New Market.

Table 1. Descriptive Statistics

Descriptive statistics of all variables used in the study from 2001 to 2012. The definition of variables is reported in section 3.

Variable	Mean	Median	Std Dev	Min	Max
P/B	2.06	1.52	9.99	-331.42	57.26
Q	1.70	1.25	2.17	0.22	70.72
FOR	0.11	0.00	0.31	0.00	1.00
ROE	5.77	12.17	77.66	-151.29	988.99
NM	0.21	0.00	0.41	0.00	1.00
VOT	55.08	53.10	26.31	0.00	100.00
SIZE	7.51	7.56	2.23	-7.82	13.96
LEV	60.23	61.80	23.14	0.00	99.90

Table 2 shows the correlation matrix between the variables. There is a positive correlation between foreign shareholder, P/B, Tobin's Q, ROE, firm size and NM. Moreover, there is a negative correlation between foreign shareholder, leverage

and ownership concentration. These results indicate that companies with foreign investors are bigger, less leveraged, have higher valuation, profitability and better governance practices.

Table 2. Correlation Matrix

Matrix of correlation of all variables used in the study from 2001 to 2012. The definition of variables is reported in section 3.

	<i>P/B</i>	<i>Q</i>	<i>FOR</i>	<i>ROE</i>	<i>SIZE</i>	<i>LEV</i>	<i>NM</i>	<i>VOT</i>
<i>P/B</i>	1.00							
<i>Q</i>	-0.57	1.00						
<i>FOR</i>	0.02	0.05	1.00					
<i>ROE</i>	0.12	0.08	0.03	1.00				
<i>SIZE</i>	0.08	-0.18	0.06	0.13	1.00			
<i>LEV</i>	0.29	-0.06	-0.04	0.01	0.13	1.00		
<i>NM</i>	0.09	0.09	0.16	0.08	0.04	-0.04	1.00	
<i>VOT</i>	-0.01	-0.03	-0.13	-0.04	-0.06	-0.01	-0.38	1.00

Table 3 shows the mean and the median of financial and governance variables of the companies divided into 2 groups: companies with Brazilian and foreign shareholders. The table also shows the p-values of the tests of differences in mean and median to analyze if there are significant differences between both groups of firms.

The results indicate that foreign-controlled firms are larger and have higher profitability, value, and better governance practices. The average ROE of foreign companies is 14.87% versus 4.56% of

Brazilian companies. Foreign companies have Tobin's Q and price-to-book (1.98 and 2.49, respectively) higher than those of Brazilian companies (1.66 and 1.99, respectively). The proportion of foreign companies in the New Market (30%) is higher than that of Brazilian companies (20%). The largest shareholder has less voting capital in foreign companies when compared to Brazilian firms (51.46% and 55.53%, respectively). Most of the differences are statistically significant at the 1% or 5% levels.

Table 3. Firm Characteristics by Foreign or Brazilian Shareholding

The sample was divided in two groups: companies with Brazilian and foreign shareholders. The mean and median (in parenthesis) of each variable are reported. The definition of the variables is reported in section 3. We performed a test of differences in mean and median to analyze the existence of a significant difference between the two groups, and the p-value of the test is reported. ***, **, and * indicate statistical difference at 1%, 5% and 10%, respectively

<i>Variables</i>	<i>Foreign-Owned</i>	<i>Brazil-Owned</i>	<i>P-value of test of differences</i>
<i>P/B</i>	2.49 (1.76)	1.99 (1.51)	0.33 (0.02**)
<i>Q</i>	1.98 (1.52)	1.66 (1.24)	0.34 (0.00***)
<i>ROE</i>	14.87 (15.31)	4.56 (11.71)	0.02** (0.00***)
<i>SIZE</i>	8.02 (8.13)	7.44 (7.45)	0.00*** (0.00***)
<i>LEV</i>	57.60 (56.50)	58.48 (56.00)	0.54 (0.81)
<i>NM</i>	0.30 (0.00)	0.20 (0.00)	0.00*** (0.00***)
<i>VOT</i>	51.46 (51.70)	55.53 (53.10)	0.03** (0.07*)

Table 4 shows the results of panel regressions for price-to-book and Tobin's Q as dependent variables. The dummy variable for foreign shareholding is positive and statistically significant for Tobin's Q. For the price-to-book, the dummy

variable for foreign shareholding has the expected sign (positive), but the result is not statistically significant. These results indicate that there is a significant relationship between the presence of foreign investors and higher firm valuation.

Table 4. Firm Value and Foreign Shareholding

Fixed-effects panel regressions where the dependent variables are the price-to-book (P/B) and Tobin's Q (Q) from 2001 to 2012. The definition of variables is reported in section 3. The p-values adjusted by autocorrelation and heteroscedasticity are reported in parenthesis. ***, ** and * indicate statistical significance at 1%, 5% and 10%, respectively.

<i>Independent Variable</i>	<i>Dependent Variable</i>	
	<i>P/B</i>	<i>Q</i>
FOR	0.21 (0.54)	0.22** (0.05)
ROE	0.01 (0.16)	0.01 (0.12)
SIZE	-0.02 (0.95)	-0.57*** (0.00)
LEV	0.30*** (0.00)	-0.01 (0.44)
NM	0.39 (0.45)	0.44*** (0.01)
R ² adj	0.58	0.36

5. CONCLUSION

The objective of this study is to investigate the relation between firm value, governance and presence of foreign shareholders in the capital of Brazilian companies. We analyzed 215 listed companies from 2001 to 2012, and find a significant relationship between the presence of foreign investors and higher firm valuation, higher profitability and better corporate governance.

REFERENCES

1. Barontini, R.; Bozzi, S. Board compensation and ownership structure: empirical evidence for Italian listed companies. *Journal of Management & Governance*, v.15, n. 1, p. 59-89, 2011.
2. Berle, A.; Means, G. *The modern corporation and private property*. New York: MacMillan, 1932.
3. Chan, K.; Covrig, V.; e NG, L. (2005). What determines the domestic bias and foreign bias? Evidence from mutual fund equity allocations worldwide. *Journal of Finance*, v. 60, p 1495 - 1534, Jun. 2005.
4. Claessens, S., Djankov, S., Pohl, G. *Ownership and Corporate Governance: Evidence from the Czech Republic*. World Bank Seminar, 1997.
5. Gillan, S., Starks, L. *Corporate Governance, Corporate Ownership, and the Role of Institutional Investors: A Global perspective*. *Journal of Applied Finance*, p.4-22, Fall/Winter 2003.
6. Grinblstt, M., Keloharju, M. How Distance, Language and Culture Influence Stockholdings and Trades. *The Journal of Finance*, v. 56, n. 3, p. 1053-1083, 2001.
7. Guerra, K., Caramico, A., Gasparelo, L. O Efeito do Investment Grade nos países emergentes. VII Congresso Virtual Brasileiro de Administração, 2011.
8. Kim, J., Kang, J. Do Foreign Investors Exhibit a Corporate Governance Disadvantage? An Information Assymmetry Perspective. *Journal of International Business Studies*, v. 41, p. 1415-1438, 2010.
9. La Porta, R. et al. Law and finance. *Journal of Political Economy*, v. 106, p. 1113-1155, 1998.
10. Leal, R. P. C.; Carvalho Da Silva A. L. Controle Compartilhado e o valor das empresas brasileiras, RAC Electronica, Curitiba, v.2, n.2, p. 296-310, Mai-Ago 2008.
11. Moskowitz, T., Coval, J. The Geography of Investment: Informed Trading and Asset Prices. *Journal of Political Economy*, v. 109, n. 4, p. 811-841, 2010.
12. Silveira, A., Barros, L., Famá, R. Determinantes do Nível de Governança Corporativa das Companhias Abertas Brasileiras. VII SEMEAD - Pesquisa Quantitativa Finanças, 2004.