Emerging Markets Review 20 (2014) 176–195

Contents lists available at ScienceDirect

Emerging Markets Review

journal homepage: www.elsevier.com/locate/emr

The evolution of corporate governance in Brazil☆☆,★

Bernard S. Black [a,*], Antonio Gledson de Carvalho [b,1], Joelson Oliveira Sampaio [b,2]

[a] Northwestern University, School of Law and Kellogg School of Management, 375 E. Chicago Ave, Chicago, IL 60611, United States
[b] FGV-EAESP, Av Nove de Julho, 2029 — Sala 912, São Paulo, SP 01313-902, Brazil

ARTICLE INFO

Article history:
Received 13 May 2013
Received in revised form 1 February 2014
Accepted 3 April 2014
Available online 13 April 2014

JEL classification:
G18
G30
G34
G39
K22
K29

Keywords:
Brazil
Corporate governance
Boards of directors
Minority shareholders

ABSTRACT

We use extensive hand collected surveys reporting governance practices of Brazilian firms in 2004, 2006, and 2009 to build a broad corporate governance index and analyze the evolution of corporate governance in Brazil and the association between governance and firm value. We find that corporate governance practices improved significantly over this period. This evolution is due to two main factors: 1) growth in Novo Mercado and Level II (NM&L2) listings, mainly through IPOs by new firms, and 2) improved practices at non-NM&L2 firms, principally through adopting governance elements required for NM&L2 listing. Governance practices for firms already listed on NM&L2 were stable. Adoption of the elements of our governance index that are required for NM&L2 listing predicts higher firm value. In contrast, adoption of the remaining elements of our index does not predict firm value. Thus, governance changes appear to respond to investor preferences.

☆☆ This paper can be downloaded without charge from the Social Science Research Network electronic library at: http://ssrn.com/abstract=2181039.

★ The authors thank Humberto Gallucci Netto and Pedro Luiz Aprigio for their excellent research assistance. We are grateful for valuable comments from an anonymous referee. We acknowledge the support of BMF&Bovespa, the Brazilian Institute for Corporate Governance, and the Global Corporate Governance Forum.

* Corresponding author. Tel.: +1 312 503 2784.
E-mail addresses: bblack@northwestern.edu (B.S. Black), gledson.carvalho@fgv.br (A.G. de Carvalho), joelson.sampaio@fgv.br (J.O. Sampaio).
[1] Tel.: +55 11 3799 7767.
[2] Tel.: +55 11 3799 3547.

http://dx.doi.org/10.1016/j.ememar.2014.04.004
1566-0141/

1. Introduction

As Claessens and Yurtoglu (2013) note in a recent survey of emerging markets, “the dynamic aspects of corporate governance reform are not yet well understood.” We might add that the evolution of corporate governance over time has rarely been studied. This paper is an effort to begin to fill that gap. We first provide descriptive evidence on the evolution of corporate governance in Brazil over 2004–2009, a period of rapid change. We then connect those changes in governance to changes in firm value, and provide evidence on *which* governance changes predict higher value.

Brazil is a good place to study changes in corporate governance because its economy went through major changes in the past decades which made it both more feasible and more attractive for firms to raise equity capital, including specific actions to change corporate governance. Economic changes include strong economic growth; achievement of macroeconomic stability; investment grade status for the government and many individual firms; major Brazilian firms becoming world-class competitors; revival of the stock market (including the rise of Novo Mercado); and development of pension funds, which became major investors in public company shares. Table 1 provides an overview of some of the major changes.

Significant changes were also observed in the stock market. Through the early 2000s, Brazil was seen as having relatively weak corporate governance. In a ranking of 49 countries based on 1997 corporate standards, Nenova (2003) placed Brazil 24th for investor rights, 43rd for enforcement of corporate law, and 40th for accounting standards. Moreover, Brazilian law allows for both voting and non-voting shares, and many Brazilian corporations are controlled by shareholders who own a majority of the corporation's voting shares, but a smaller economic interest.[3] Examples of expropriation of minority shareholders by controlling shareholders were common. Dyck and Zingales (2004) estimated the benefits of corporate control in 39 countries, based on the difference between trading prices and prices paid for control blocks. They found that Brazil had the greatest average control benefits, estimated at 65% of equity value.

In 2000, in response to a loss of trading volume to other markets, and the belief that loss of trading volume was related to weak protection for minority shareholders (including extensive use of non-voting shares, few outside directors, and low levels of disclosure), the São Paulo Stock Exchange (BM&FBovespa below "Bovespa") created three high-governance listings (Novo Mercado, Level I and Level II). This contributed to a surge in initial public offerings, which had been nearly non-existent until 2004; a leveling off in the number of listed companies, which had been shrinking; and sharply rising trading volume and liquidity (De Carvalho and Pennacchi, 2012). Most new listings were at one of the premium listing levels; some older companies also migrated their listings to a higher level. The proportion of companies listed on one of these premium markets has soared (see Table 2 below for details).[4]

In spite of these major changes in the economy and the stock market, little is known about how corporate governance standards have been changing, or how those changes affect firm value. This article aims at filling this gap by providing a picture of the evolution of corporate governance practices in Brazil. Our data comes from three extensive hand collected surveys we conducted on their governance practices, roughly in 2004, 2006, and 2009. Thus, the first survey comes at the beginning of the surge in IPOs in 2004; the second in the middle of the IPO surge; an the third during the financial-crisis-related lull in new listings.

One problem in describing corporate governance is that it is multifaceted — one can drown in details. To address this issue, we aggregate our governance information into six indices covering the main aspects of corporate governance: board structure, ownership, board procedures, related party transactions, shareholder rights, and disclosure. The Board Structure Index is subdivided into two subindices: one for Board Independence, the other for Audit Committee and Fiscal Board. Finally, we compute a broad Brazilian Corporate Governance Index (BCGI), as the average of these 6 indices. We focus on “private” Brazilian firms, and exclude government-controlled and foreign-controlled firms.

[3] As of 2000, 89% of Bovespa-listed corporations had issued non-voting shares, representing 54% of all shares listed on Bovespa and the vast majority of trading volume (Nenova (2005)).

[4] In 2008, Bovespa created a fifth “Bovespa Mais” market, which is similar to Novo Mercado but removes some requirements, principally the need for 25% free float. As of 2009, there was only one firm at this listing level, and none in our sample. Totals for all listed firms exclude this firm.