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Corporate governance in Brazil

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A B S T R A C T

We examine the corporate governance practices of Brazilian public companies. We identify areas where their governance is relatively strong and weak. Many firms have small boards, comprised entirely or almost entirely of insiders or representatives of the controlling family or group. Even some very large firms have no independent directors. Formal board processes are limited. Audit committees are uncommon, but many firms use a substitute body—the fiscal board—which does not require that the firm have independent directors to staff the audit committee. Financial disclosure is mixed. Some firms voluntarily provide English language disclosure, but many do not provide cash flow statements or consolidated quarterly financial statements. Brazilian corporate law often provides limited protection to minority shareholders, but the Brazilian stock exchange, Bovespa, provides optional governance rules which go beyond the legal minimums. These optional rules have become increasingly popular with Brazilian firms.

1. Introduction

We know remarkably little about the details of firm-level governance in emerging markets. This paper seeks to address that gap in Brazil—one of the most important of these markets. Cross-country studies of governance provide only high level comparisons between countries—for example, mean scores on disclosure (Patel et al., 2002) or overall governance (Bruno and Claessens, 2007). They also rely on somewhat old data. The principal governance measures used in these studies are the Standard & Poor's transparency and disclosure survey (2002, not repeated), and the Credit Lyonnais Securities Asia survey

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(2001, not repeated). Country studies also typically provide little beyond summary statistics for overall governance and particular governance measures. A fine grained picture is missing.[3] This paper provides that more nuanced picture, for Brazilian corporate governance in 2005. Brazil is an interesting country to study both because of its size and because it has high private benefits of control and relatively weak corporate governance.[4]

Within Brazil, this is the first study to collect data on corporate governance, beyond the limited data available from public disclosures. Even such basic information as the number of independent directors of public companies was previously not available. Leal (2007) provides a survey of prior work on Brazilian corporate governance.

One major area of weakness involves boards of directors. Many firms have boards too small to be effective. Many have no independent directors at all, or a lone token independent director. Formal processes are limited. Audit committees are uncommon, but Brazil has developed a substitute body—the fiscal board—which does not require that the firm have independent directors to staff the audit committee. Financial disclosure is mixed. Some firms voluntarily provide English language disclosure. At the same time, many firms do not provide cash flow statements or consolidated quarterly financial statements.

Almost all Brazilian firms have a controlling shareholder or group. However, Brazilian corporate law provides relatively limited protection to minority shareholders. Bovespa has filled part of this gap, by providing several sets of optional governance rules which go beyond the legal minimums (Bovespa, 2008). Most recent IPOs have been on Bovespa's higher levels, and migration to a higher level increases trading volume (De Carvalho and Pennacchi, 2009). Bovespa's role in fostering stronger corporate governance is reminiscent of the role played by the U.S. and U.K. stock exchanges in the early 20th century (Cheffins, 2009; Coffee, 2002; Mahoney, 1997).

1.1. Literature review

Many Brazilian public firms use dual-class structures, with insiders retaining voting common shares and outsiders holding primarily non-voting preferred shares, which have economic rights similar to common shares. Valadares and Leal (2000) and Leal et al. (2000) find a high concentration of voting power in Brazilian firms, due in large part to this practice. Da Silveira et al. (2008) study firm-level corporate governance in Brazil from 1998 to 2004 using an index based on public data (see also Leal and Carvalhal-da-Silva, 2007). They find no significant explanatory factors for firms' governance choices, but this might reflect the data limitations they faced in building their index. Dutra and Saito (2002) study the effect of cumulative voting on board composition as of 2000 for actively traded Brazilian firms, but find little use of cumulative voting. They use family names as a crude measure of director independence. Da Silveira et al. (2004) find a positive association between separation of Chairman and CEO and Tobin's q.

Several papers use legal changes in takeout rights as a natural experiment, and study the effect of these rights on share prices. Prior to 1997, Brazilian corporate law required a new controller, who acquired 50% of the common shares, to offer to buy all remaining common shares, at the per-share price paid when acquiring control. In 1997, Brazil removed this rule, but reinstated takeout rights in 2000, at 80% of the per-share price paid for the controlling shares. Nenova (2005) and Carvalhal-da-Silva and Subramanyam (2007) report conflicting results on how these law changes affected the premium accorded to common shares, relative to preferred shares (which the takeout rights rules never covered). Bennedsen et al. (2008), report that during 2000–2006, some Brazilian firms voluntarily provided additional takeout rights to common shareholders, preferred shareholders, or both, in connection with equity offerings.

Brazilian corporate governance is in a period of rapid change. Historically, Brazilian financial markets were heavily regulated (Gorga, 2006). In 1976, the Brazilian securities commission, Comissao de Valores Mobiliarios (CVM), was created and a new Corporations Law was adopted, which included rules governing

[3] See, for example, Black et al. (2006). The only study we know of which provides a similarly detailed picture of firm-level governance choices is a contemporaneous study of India (Balasubramanian et al., 2009). Choi et al. (2007) provide some details on the composition of Korean boards of directors during 1999–2002.

[4] Dyck and Zingales (2004) study the premium paid for control blocks in 39 countries; of these, Brazil has the highest average premium, at 65% of the trading value of the shares. Nenova (2003) estimates that Brazil has a relatively high value of control, at 23% of firm value, and low scores on international measures of investor rights, corporate law enforcement, and disclosure.

public companies and stock exchanges. During the 1970s and 1980s, the government granted tax incentives to firms that went public and investors who purchased shares in public companies, and required pension funds and insurance companies to invest in the shares of public companies. By the end of the 1980s, there were almost 600 publicly traded companies, but a significant number had gone public only to capture the tax incentives, and had no interest in having public shareholders or active trading of their shares.

In the late 1980s, the financial incentives for going public were eliminated; since then, many firms which went public due to tax incentives have returned to private ownership. The government also began an extensive privatization program. By the end of the 1990s, a large fraction of share trading involved privatized companies. Many large Brazilian firms cross-listed on the New York Stock Exchange (NYSE), and a significant portion of trading moved to the NYSE. Privatizations aside, there were almost no IPOs. Brazilian corporate law, on the whole, provides limited protection for minority shareholders. In 2000, Bovespa launched three new listing segments, Level 1, Level 2 and Novo Mercado, with stronger corporate governance rules than the legal minimum, while allowing existing firms to retain a regular Bovespa listing, with weaker governance requirements.

This paper proceeds as follows. Section 2 describes our survey (data sources and sample), the overall size of the Brazilian public market, and the cross-listing and Bovespa listing choices made by Brazilian firms. Sections 3–9 cover, respectively, boards of directors; board and committee procedures; oversight of financial reporting by the audit committee and the fiscal board; shareholder meetings and shareholder rights; related party transactions and executive compensation; financial and other disclosure; and control and shareholder agreements. Section 10 concludes.

2. Governance survey methodology and sample

Our results are based primarily on an extensive survey distributed in January 2005 to all firms listed on Bovespa, Brazil's principal stock exchange (2005 Brazil CG Survey). We received 116 replies to the survey, including 17 from government-controlled firms, and 11 from subsidiaries of foreign companies, and 88 from privately controlled firms (*Brazilian private firms*). We focus in this article on results for Brazilian private firms. We promised confidentiality to all respondents, and thus do not name individual firms in this paper. We received 116 responses, for a response rate of 32%, including a 28% response rate for Brazilian private firms.[5]

We use several additional data sources. The list of publicly traded companies is from Bovespa, at www.bovespa.com.br/principal.asp. Market capitalization comes from Bovespa. Financial data comes from the Brazilian financial database Economatica, available at www.economatica.com. Basic company information comes from annual reports, available from InfoInvest at www.infoinvest.com.br. Information on Bovespa listing levels comes from Bovespa. Information on cross-listing exchanges, levels, and dates comes from the Bank of New York, at www.adrbny.com, Citibank, at wwss.citissb.com/adr/www/brokers/index.htm, CVM, at www.cvm.gov.br, Deutsche Bank, at www.adr.db.com, and JP Morgan, at www.adr.com.

Table 1 provides basic information on all publicly traded Brazilian firms, firms with at least somewhat active trading (the firm's shares traded, on average, at least once every 2 weeks), and the firms which responded to the survey.

Table 2 provides a breakdown of Brazilian private firms by market capitalization quartile. The top quartile of firms by size represent 93% of the market capitalization of all Brazilian private firms, while the bottom half of firms are quite small and together represent only 0.4% of market capitalization. The largest private firm by market capitalization (Vale do Rio Doce) has twice the market value of the entire bottom three quartiles. Many smaller firms have very limited trading, and perhaps should not be considered as public firms at all.

Our response rate was substantially higher for larger firms. For example, we received responses from 41% of the largest quartile of firms, and 54% of the 39 firms in the largest octile of firms. Responding firms include 61% of the market capitalization of all Brazilian private firms (63% of the market capitalization of

[5] The survey (in Portuguese) and an English translation are available from the authors on request. Two firms answered only the first part of the survey. Thus, for many questions, we have 86 responses from Brazilian private firms instead of 88. For particular questions, we also have occasional missing or ambiguous responses, these are noted below.

Table 1
Sample characteristics: all firms and responding firms.

Number of firms	All public firms	Responding firms	Percent	Actively traded firms	Responding firms	Percent
All firms	358	116	32%	229	87	38%
Private	313	88	28%	194	66	34%
State	24	17	71%	19	14	74%
Foreign	21	11	52%	16	7	44%
Market cap (R$ billions)						
All firms	871	441	51%	833	433	52%
Private	557	337	61%	523	332	63%
State	167	51	31%	165	50	30%
Foreign	147	54	36%	144	51	35%

This table presents the total number of firms and market capitalization for (i) all publicly traded Brazilian firms, (ii) firms with active trading (trading on at least 26 days during 2004), and (iii) firms which responded to the 2005 Brazil CG Survey, separated into firms with Brazilian private control, state control, and foreign control. Data is as of January 2005. Exchange rate as of December 31, 2007 is R $1.80 per US$1.

Table 2
Sample characteristics: Brazilian private firms, by size quartile.

Quartile	Size Range in reais R$	Number of firms			Market capitalization			
		Total	Responding firms	Responding as % of quartile	All firms in quartile	% of total	Responding firms	Responding as % of quartile
1	1,061 to 86,739	78	32	41.0%	515,919	92.6%	322,734	62.4%
2	172 to 991	78	24	30.8%	35,151	6.3%	12.478	35.5%
3	20 to 158	78	21	26.9%	5,592	0.3%	1.666	29.9%
4	0 to 19	79	11	13.9%	465	0.1%	54	11.6%
	Total	313	88	28.1%	557,128	100%	336,933	60.5%

This table presents the total number of firms and market capitalization for Brazilian private firms which responded and did not respond to the 2005 Brazil CG Survey, divided into quartiles based on market capitalization. Market capitalization is in R$ millions. Data is as of January 2005. Exchange rate is R$2.62 per US$1.

actively traded firms). Thus, in terms of market capitalization, our sample is reasonably representative of the Brazilian stock market.

2.1. Listing levels: Bovespa and cross-listing

In 2000, Bovespa created a family of voluntary listing levels, with increasingly strict corporate governance requirements. The higher levels provided investors with a readily understood signal of their corporate governance posture. Bovespa listing levels now include regular Bovespa, Level 1, Level 2, and Novo Mercado (New Market).

A Novo Mercado listing requires, among other things, that the firm issue only voting common shares; have a minimum free float (shares not controlled by the controlling shareholders) of 25%; provide financial statements which comply with U.S. GAAP or IAS; provide takeout rights to minority shareholders in a transfer of control; and agree that conflicts with shareholders will be resolved by arbitration. Level 2 is similar to Novo Mercado, but allows firms to issue preferred shares. Level 1 is a small step up from an ordinary listing, and focuses on improved disclosure.

Cross-listing provides another way for Brazilian firms to signal their intent to maintain a higher level of disclosure and other corporate governance practices.[6] Table 3 summarizes the Bovespa and foreign cross-listing decisions of the responding Brazilian private firms at the date of our survey. Nineteen firms in our sample (22%) have cross-listed their shares. Most of these firms cross-list only preferred shares. Three firms in our sample are listed on Bovespa Level 2, and two are listed on Novo Mercado.

[6] Liu (2007) provides evidence that cross-listing in the U.S. enhances home-market pricing efficiency.

Table 3
Listing on foreign exchanges and different Bovespa levels.

Panel A. Foreign cross-listing

Type of shares	Common	Preferred	Both	Neither
US cross-listed firms (% of firms in sample)	1 (1%)	17 (18%)	2 (2%)	68 (78%)
NYSE	1	15	2	–
Level 1 (OTC)	0	1	0	–
Level 4 (Portal)	0	0	0	–
Non-U.S. listing	0	6	1	–

Panel B. Bovespa listing level

	Regular	Level 1	Level 2	Novo Mercado	TOTAL
Bovespa level	66	17	3	2	88

This table presents the firms which have common shares, non-voting preferred shares, or both cross-listed on a foreign stock exchange. Sample is 88 Brazilian private firms which responded to the 2005 Brazil CG Survey. Seven firms are listed both on the NYSE and on a non-U.S. exchange.

Table 3 offers a snapshot of cross-listing and Bovespa listing in the first half of 2005. But this picture has been changing rapidly. From 1995 to 2003, there were only six initial public offerings by Brazilian firms—an average of less than one per year. The number of public companies shrank from 599 in 1998 to 390 in 2004 (358 with publicly traded shares). The number of IPOs then soared to 7 in 2004; 9 in 2005, 26 in 2006, 64 in 2007, and 4 in 2008. Of these IPOs, 78 were on Novo Mercado, 15 on Bovespa Level 2, 8 on Bovespa Level 1, 8 (all cross-listed firms) on regular Bovespa, and one on the new Bovespa Mais small-firm market. In addition, a number of older firms upgraded their governance to Level 1 or higher.

Only 4 of the newly public firms cross-listed on the NYSE. A much more popular option was to cross-list in the U.S. at cross-listing levels 1 (OTC market) or 4 (Portal market, limited to institutional investors). Thus, a time series picture of cross-listing and Bovespa listing level choices is valuable. Table 4 provides this picture. It shows the number of Brazilian public firms—whether in our sample or not—which are cross-listed in the U.S., their cross-listing level, how many are cross-listed on foreign exchanges, and how many are listed on different Bovespa levels.

As Table 4 shows, the number of Brazilian firms listed on the New York Stock Exchange or NASDAQ grew steadily through 2002 and then levels off. It is probably not a coincidence that the U.S. Sarbanes–Oxley Act (SOX), which applies to these firms, was adopted in 2002. Another factor in cross-listing

Table 4
Listing decisions over time: cross-listing and Bovespa level.

Year	Foreign cross-listing		Regular	Bovespa listing			
	NYSE or NASDAQ	U.S. (total cross-listings)		Level 1	Level 2	Novo Mercado	Total
1995	2	23	577	These levels were created in 2000			577
1996	3	35	589				589
1997	7	39	595				595
1998	17	53	599				599
1999	19	56	534				534
2000	22	60	494	0	0	0	494
2001	26	66	450	18	0	0	468
2002	33	72	407	24	3	2	436
2003	34	72	374	31	3	2	410
2004	35	76	343	33	7	7	390
2005	35	79	316	37	10	18	381
2006	32	82	300	36	14	44	394
2007	31	87	293	40	18	82	433
2008	31	94	279	43	18	99	439

This table presents the number of Brazilian public companies which are cross-listed outside Brazil (principally in the U.S.) and listed on the indicated Bovespa levels. Some firms with a regular Bovespa listing have public debt but not public equity. Data is provided by Bovespa, and is at year-end.

Table 5
Size of the board of directors.

No. of Directors	No. of firms	Percentage
3	14	16%
4–5	22	25%
6–7	26	30%
8–11	21	24%
12 or more	5	6%
	Mean = 6.8	Median = 6

This table presents the board size and percentage for 88 Brazilian private firms which responded to the 2005 Brazil CG Survey. Minimum legal size is 3 directors.

Table 6
Size of the board of directors by size quartile.

Quartile	Size Range (reais)	Firms in sample	Percentage	Mean	Median	Min.	Max.
4	1,061 to 86,739	32	36%	8.59	8	3	22
3	172 to 991	24	27%	5.96	6	3	10
2	20 to 158	21	24%	5.57	5	3	11
1	0 to 19	11	13%	5.64	5	3	11
	Total	88	100%	6.78	6	3	22

This table presents the board size and percentage for 88 Brazilian private firms which responded to the 2005 Brazil CG Survey. Minimum board size under Brazilian law is 3 directors. Quartiles are based on market capitalization as of Jan. 2005. Amounts in R$ millions.

decisions is likely Brazilian firms' ability to signal corporate governance by listing on Level 2 or Novo Mercado. This could reduce the value of the signal provided by a U.S. level-2 or level-3 cross-listing.[7]

3. Composition of the board of directors

Brazilian law requires public companies to have a board of directors, with at least three members. Firms that list on Bovespa Level 2 or Novo Mercado must have at least 5 member boards.[8] In practice, most firms have relatively small boards. As Table 5 shows, over two-thirds of responding firms have boards with 3–7 board members, with a mean (median) of 6.8 (6) members. Only five firms (6%) have more than 11 directors.

A common corporate governance concern is that boards can be too large to be effective (e.g., Yermack, 1996). In Brazil, in contrast, it seems likely that some boards are too small to be effective. The members of a small board will have a limited range of expertise, and cannot effectively delegate some of their work to committees. The overall work to be done by the board might simply exceed the capacity of a small group of people.

Table 6 shows board size for different ranges of firm size. The largest firms tend to have larger boards. However, some large firms still have quite small boards, including one firm with only 3 directors. Once we move below the first size quartile, board size is similar regardless of firm size. *T*-tests for differences in means confirm that the largest quartile firms have significantly larger boards (*T*-stats vs. other quartiles from 2.64 to 3.02).

Brazil has no legal requirements for board independence. Only one-third of board members may be company officers. But at many firms, some or all of the non-executive directors represent the controlling family or group. In Brazil, information on director independence is not publicly available. We asked respondents to consider a person to be an *independent director* if this person is not an officer or former officer of the company and is independent of the controlling shareholder, shareholder group, or family.

[7] In Table 4, we show cross-listing only in the U.S. but not in other countries. Relatively few Brazilian firms cross-list in other countries; of these, all but one (Bradespar, cross-listed in Madrid) also cross-list in the U.S. If a firm has shares cross-listed on more than one level, we report the highest listing level, based on regulatory stringency (level 3 > level 2 > level 1 > level 4).

[8] For additional details on the survey responses, and citations to Brazilian law and Bovespa rules, see Black et al. (2009).

Table 7 reports the number and percentage of independent directors on Brazilian boards. By international standards, Brazilian firms have remarkably few independent directors. Over a third of the responding firms (31/80) have no independent directors. Another 19% have only a single independent director. Only 12% have a majority of independent directors. Overall, only 23% of directors are independent.

The tendency for Brazilian firms to have either no or few independent directors is not limited to smaller firms. Table 8 divides our sample into size quartiles based on market capitalization. Even the largest firms often have no independent directors. The larger percentage of independent directors for the smallest quartile of firms is not statistically significant, and could reflect sample selection bias among the small firms which responded to the survey. *T*-tests for differences find no significant differences between quartiles in either the likelihood of having an independent director, or the proportion of independent directors.

Under Brazilian law, common shareholders holding at least 10% of the common shares can demand cumulative voting. However, cumulative voting is uncommon in practice. Only 10 responding firms (12%) had used cumulative voting in the last 5 years. Cumulative voting was used once at four firms, twice at four firms, three times at one firm, and in all 5 years at one firm.

3.1. Minority shareholder representation

Minority shareholders also have the legal right to elect one representative by majority vote, as follows: (1) minority common shareholders, if minority common shares are at least 15% of total common shares; (2) preferred shareholders, if preferred shares are at least 10% of total shares; and (3) all minority shareholders together, if they hold at least 10% of total shares and neither the common shares nor the preferred shares threshold is met. As a practical matter these rights are available primarily to large minority shareholders who can show up at the shareholder meeting, nominate a director, and cast enough votes to elect this person.

Table 9 reports, for the 52 firms with at least one independent director, whether any independent directors represent minority shareholders. Twenty-eight of these firms (42% of firms with preferred

Table 7
Proportion of independent directors.

No. of Independent Directors	No. of firms	Percent	Proportion of Independent Directors	No. of firms	Percent
0	31	36%	0%	31	36%
1	16	19%	1–10%	2	2%
2	17	20%	11–30%	20	23%
3	13	15%	31–50%	23	27%
4 or more	9	10%	51% or more	10	12%
	Mean = 1.58	Median = 1.0		Mean = 23%	Median = 18%

This table presents the number and percentage of independent directors, for 86 Brazilian private firms which responded to the 2005 Brazil CG Survey and provided data on board composition. In computing proportion of independent directors, percentages are rounded up to next whole number.

Table 8
Board independence by size quartile.

Size Quartile	Sample	Firms with no indep. directors	No. of indep. directors			Proportion	
			Mean	Median	Max.	Mean	Median
4	32	9 (28%)	1.9	2	6	24%	20%
3	23	10 (44%)	1.4	1	6	21%	14%
2	20	10 (50%)	1.1	1	4	18%	9%
1	11	2 (18%)	2.0	2	7	38%	40%

This table presents the number and percentage of independent directors, by size quartile, for 86 Brazilian private firms which responded to the 2005 Brazil CG Survey and provided data on board composition. Quartiles are based on market capitalization as of Jan. 2005.

Table 9
Board representation of minority shareholders.

Number of Directors in category	Preferred shareholders	Percent	Director represents			
			Minority common shareholders	Percent	Either preferred or minority common shareholders	Percent
None	28	58%	30	58%	19	37%
1	17	35%	14	27%	16	31%
2	2	4%	7	14%	13	25%
3	1	2%	1	2%	3	6%
4	0	0	0	0	1	2%
One or more	20	42%	22	42%	33	63%

This table presents the number of directors who represent preferred shareholders or minority common shareholders, for 52 Brazilian private firms which responded to the 2005 Brazil CG Survey, provided data on board composition, and have at least one independent director. Of these firms, 48 have issued preferred shares.

shares) have a representative of the preferred shareholders; 30 firms have a representative of the minority common shareholders; and 33 firms have a representative of one or both groups of minority shareholders. Including firms with no independent directors, 33/80 (41%) of the responding firms have one or more independent directors who represent minority shareholders. *T*-tests for differences in proportions find no significant differences between size quartiles in the likelihood of having a minority shareholder representative on the board.

3.2. CEO and chairman split

A common governance recommendation is that the CEO and Chairman positions should be split, to prevent the CEO from having too much power over the firm. This concern is less important when the CEO faces oversight from a controlling family or group. Most Brazilian firms have different persons as CEO and Chairman; 62 of the 88 respondents (71%) separate these roles. The common Brazilian pattern is for the chairman to represent the controller. We know of no research on whether separating these roles is valuable for family-controlled firms.

3.3. Director's terms

Under Brazilian law, directors can serve for terms of up to 3 years (Level 2 and Novo Mercado firms are limited to 2-year terms). Directors are subject to removal by shareholders at any time. In practice, multiyear terms are common: almost half of the respondents (42/88; 48%) use the maximum 3-year term permitted by the law; another 15 firms (17%) have two year terms. Only 2 respondents use staggered board terms.

4. Board procedures

4.1. Board meetings

Brazilian law does not require a minimum number of board meetings. Table 10 provides information on board meetings held during 2004. Most Brazilian firms hold at least 4 meetings per year. If four physical meetings is a minimum for an effective board, only seven firms (8%) failed this standard. However, two firms did not have a single physical meeting for the entire year. We found no significant differences in number of meetings between large firms (size quartiles 3 and 4) and smaller firms.

Two-thirds of the responding firms (58/87) had between four and 12 meetings per year, which is a normal number by international standards. However, ten firms reported 19 or more physical meetings. Some of these firms might have a regular management meeting and call it a board meeting (only two of them had an independent director).

Table 10
Meetings of the board of directors.

Number of Meetings	Total meetings	%	Physical meetings	%	Telephone meetings	%
0	0	0	2	2	75	87
1–3	3	3	5	6	4	5
4–6	24	28	25	29	4	5
7–9	16	18	15	17	1	1
10–12	21	24	18	21	1	1
13–18	8	9	12	14	0	0
19 or more	15	17	10	12	1	1

This table presents the number of total, physical, and telephonic board meetings in 2004 for 87 Brazilian private firms which responded to the 2005 Brazil CG Survey and provided this information.

4.2. Minutes and other board procedures

A standard corporate governance recommendation is that companies prepare written minutes of board meetings, which indicate who attended the meeting, the issues voted on, and the voting outcomes. Brazilian law requires firms to keep minutes of board meetings. Nonetheless, five firms (6%) did not keep written minutes. Only about half (41 of 83 respondents on this question) recorded directors' votes in the minutes. Table 11 summarizes Brazilian practice for selected board processes. On the whole, Brazilian boards have relatively few formal processes. This is consistent with many boards being small and dominated by the controller.

Only about a third of responding firms (28/88) formally evaluate the CEO's performance. A slightly larger number (34/88; 38%) evaluate other officers. Only 15 firms (21%) have a succession plan. For some, however, the controlling family may have an informal plan. Most companies (91%) provide materials to board members in advance of board meetings. However, only 14% formally provide for independent directors to retain their own advisors, at the company's expense.

There are some differences in board processes between firms with and without independent directors. Firms with an independent director are more likely to prepare board minutes (100% vs. 87%; p-value = 0.04); more likely to record the votes of individual directors (56% vs. 33%; p-value = 0.04), and more likely to have a succession plan for the CEO (22% vs. 6%; p-value = 0.03). We did not find significant differences in other board processes based on firm size.

Only 6 of the 52 firms with independent directors regularly review these directors' performance. At only one firm do independent directors meet regularly, without officers or other directors present. To be sure, however, such a practice likely makes sense only in firms with, say, 3 or more independent directors—only 22 firms in our sample.

Table 11
Board processes.

Process	Yes	% Yes	No/missing	Total
Affecting all directors				
Regular system for evaluating the CEO's performance	28	32%	60	88
Succession plan for the CEO	15	21%	73	88
Regular system for evaluating other officers	34	39%	54	88
Specific bylaw to govern the activity of the board of directors	48	55%	40	88
Company code of conduct or ethics	45	51%	43	88
Board members receive materials in advance of board meetings	80	91%	8	88
Independent directors can obtain outside advice at company's expense	7	14%	45	52
Affecting only independent directors				
Regular system for evaluating independent directors	6	12%	46	52
Annual meeting exclusively to independent directors	1	2%	51	52
None of the above	0		88	

This table presents the number of firms which adopted the indicated board processes, for 88 Brazilian private firms which responded to the 2005 Brazil CG Survey. Questions relating to independent directors apply only to 52 firms with one or more independent directors. The survey asked for *yes* but not *no* answers, so we cannot distinguish *no* from *missing*.

4.3. Specific board actions

We also asked about a number of important board actions. Table 12 summarizes the responses. At 20 firms (23%), the board had replaced the CEO (Portuguese: *substituiu*) within the last 5 years. This could include both dismissal for poor performance and normal replacement when the CEO retires or becomes ill. Similarly, the board of 25% of the firms had replaced one or more officers. The likelihood of CEO replacement was similar for large firms (size quartiles 3 and 4) and smaller firms, but large firms were more likely to replace another officer (32% vs. 12%; p-value = 0.02). Four firms had asked an independent director to resign, or had not renominated this person, during the last 5 years. None stated that an independent director had resigned because of a dispute over policy during this period.

5. Oversight of financial reporting

A standard corporate governance recommendation is for a firm's board to establish an audit committee, ideally staffed entirely by independent directors. This practice is not common in Brazil. Only 25 respondents (28%) have standing committees of the board for any purpose, including 15 (17%) who have an audit committee.

Moreover, even when an audit committee exists, it is often staffed entirely by inside directors. Only seven firms include even a single independent director on the audit committee; only two have a committee staffed solely by independent directors. This limits the ability of the committee to provide independent oversight of the firm's financial statements and its relations with its outside auditor.

5.1. Fiscal board

Brazil has developed an interesting substitute for the often-absent audit committee. Brazilian law authorizes a separate body, not part of the board of directors, known as a fiscal board. The fiscal board has extensive powers to investigate the company's financial reporting. Its members can offer their separate opinions on the firm's financial statements at the annual shareholder meeting, when the shareholders vote to approve the financial statements. The fiscal board can engage experts (presumably an accounting firm), at the company's expense. The fiscal board must have between 3 and 5 members.

A company can either have a permanent fiscal board, or provide for the existence from time to time of a temporary board. A temporary fiscal board must be created on demand by minority shareholders representing 10% of the common shares or 5% of the preferred shares. The temporary board's authority expires at the next annual shareholder meeting; but the shareholder demand for the board can be renewed at that meeting.

About 40% of firms have a permanent board (34/88). Twenty-nine of these firms (85%) had a specific bylaw to govern the fiscal board. Only a bit more than half of these boards (18/34: 53%) had a member with accounting expertise. Most fiscal boards meet with the external auditor either quarterly (16 firms) or annually (11 firms); but at three firms the board does not meet with the external auditor.

Next, what about the firms without a permanent fiscal board? As Table 13 indicates, at 24 of the 52 firms without a permanent board, a non-permanent board was convened in four or five of the last 5 years. Thus, two-thirds of the responding firms (58/88) have a *near*-permanent board—either a permanent or a board

Table 12
Actions of the board.

Within the last 5 years, has	Yes	% Yes	No/Missing	Total
The board replaced the CEO.	20	23%	68	88
The board replaced (or asked the CEO to replace) another officer.	22	25%	66	88
The board asked an independent director to resign, or did not propose reelection of an independent director.	4	8%	48	52
An independent director resigned because of a dispute over policy.	0	0%	52	52

This table presents the number of firms which adopted the indicated board processes, for 88 Brazilian private firms which responded to the 2005 Brazil CG Survey. Questions relating to independent directors apply only to 52 firms with one or more independent directors. The survey does not let us distinguish “no” answers from missing responses.

Table 13
Non-permanent fiscal board: how often used.

Number of times convened	Number of firms	Percentage
0	12	23
1	7	14
2	4	8
3	5	10
4	10	19
5	14	27

This table presents the number of years non-permanent fiscal board was convened during last 5 years, for 52 Brazilian private firms which do not have a permanent fiscal board and responded to this question on the 2005 Brazil CG Survey.

which was convened in at least 4 of the previous 5 years. Another 16 firms had an occasional fiscal board, convened in 1–3 of the previous 5 years. Neither firm size, industry, nor presence of independent directors significantly predicts the likelihood that a firm would have a near-permanent board.

Table 14 assesses which firms have both an audit committee and a fiscal board, one or the other but not both, or neither. Of the 28 firms without a near-permanent fiscal board, 5 have an audit committee and 23 (27%) have neither body. Only 9 firms (10%) have neither an audit committee nor a fiscal board which was convened at least once during the last 5 years.

Thus, the fiscal board is an important institution in Brazil, and often acts as a substitute for the audit committee. Further research is needed to understand its strengths and weaknesses, compared to an audit committee, and whether it makes sense for a firm to have both a fiscal board and an audit committee.

We turn next to minority shareholder representation on the permanent fiscal board. Brazilian law gives the holders of preferred shares the right to elect one member of the fiscal board, and gives minority common shareholders holding at least 10% of the common shares a similar right. The controlling group can elect the remaining members, in a number equal to those elected by minority shareholders plus one, and thus can control the fiscal board, if it chooses to. Almost all firms with a permanent fiscal board (31/34; 91%) have at least one minority shareholder representative on this board; of these, 12 firms (35%) have two or more minority representatives. At only three firms (9%) are minority shareholder representatives a majority of the fiscal board.

Even if they are outvoted, the minority shareholder representatives on the fiscal board have an important voice. They can demand to inspect the company's books, and can object individually to the company's financial statements at the annual meeting. This will, at a minimum, embarrass the company's executives and controllers. It might also lead to a CVM investigation or a closer look in the future by the external auditor.

5.2. External auditor

Brazilian public firms must have their financial statements audited by an independent auditor. They must also rotate the external auditor every 5 years, and cannot rehire the old auditor for at least 3 years. This is a stronger rule than in the U.S., where firms can keep the same auditor indefinitely, but the auditor must rotate the lead partner on the audit after 5 years. The existence of countries, like Brazil and India,

Table 14
Crosstabulation: audit committee and fiscal board.

	Near-permanent fiscal board		Occasional fiscal board		No fiscal board		Total
	No. of firms	Percent	No. of firms	Percent	No. of firms	Percent	
Audit committee	9	10%	2	2%	3	3%	14
No audit committee	49	57%	14	16%	9	10%	72
Total	58	67%	16	17%	12	14%	86

This table presents the crosstabulation table, indicating which firms have an audit committee, fiscal board, both, or neither, for 86 Brazilian private firms which responded to the 2005 Brazil CG Survey and provide information on fiscal board. *Near-permanent* fiscal board represents permanent fiscal board or board which met 4 or 5 times in the previous five years. *Occasional* fiscal board met 1–3 times in the previous 5 years.

which require auditor rotation, while other countries do not, could permit cross-country research to assess the value of mandating auditor rotation, but we are not aware of studies addressing this issue.

We asked firms whether they had replaced their external auditor within the last 5 years. In theory, all firms should have done so, but in practice, only 49 firms answered yes. Of these, 31 cited *legal reasons* (presumably the rotation requirement). Of the others, six responded that their auditor had gone out of business, six were unhappy with the auditor's fees, and six cited other reasons. No firm reported changing auditors after a dispute over accounting policy. However, such a dispute could have been an important reason for replacement in some cases.

We asked whether the auditor also performs non-audit services. Providing these services could create a conflict of interest for the auditor, since if it loses the firm as an audit client, it will likely lose non-audit contracts as well. Only 16 firms (18%) obtain non-audit services from their auditor. In part, this may be because mandatory rotation prevents long-term relationships—which could lead to firms using an auditor for non-audit services. Of these firms, only five reported that non-audit fees represented 10% or more of the auditor's total fees.

6. Shareholder meetings and shareholder rights

We discuss above the rights of minority shareholders to elect representatives to the board of directors. We discuss in this part the rights of minority shareholders in connection with shareholder meetings, sales of control, share offerings, and other matters. Brazilian law requires public companies to provide at least 15 days notice of a shareholder meeting. Most firms appear to provide the minimum notice. Only seven firms (8%) reported that they provide at least 30 days notice of shareholder meetings. These notices are also sparse. Only 12 firms (14%) include the names of director candidates in the notice of a shareholder meeting. A fair number of firms (35 firms; 41%) provide shareholders with an annual agenda of corporate events—doing so is required for firms listed on Bovespa Level 1 or higher.

6.1. Rights of preferred shareholders

Most Brazilian companies issue preferred (non-voting) shares—74 of 86 responding firms (86%) have done so. Public companies which issue preferred shares must give these shares one of three types of advantages, relative to common shares: (1) dividends 10% higher than the dividends on common shares; (2) dividends of at least 25% of net income; or (3) takeout rights on a sale of control, which provide at least 80% of the per-share price paid for the control block.

No one type of preferential rights dominates—39 firms provide higher dividends on preferred shares, 25 pay dividends of at least 25% of net income and 17 provide takeout rights. Of these 17 firms, 12 provide takeout rights at the minimum level of 80% of the price paid for control; the other 5 firms do so at 100% of this price. Table 15 summarizes these and other rights of preferred shareholders.

Table 15
Selected rights of preferred shareholders.

	Yes	% Yes
Special rights (one of these is required by law)		
10% higher dividends than on common shares	39	53%
Dividends of at least 25% of net income	25	34%
Takeout rights, at price of at least 80% of the price paid for the control block	17	23%
Voting rights		
Mergers, transformations and similar transactions	9	12%
Transactions with controlling shareholder involving conflict of interest, which require shareholder approval	6	8%
Evaluation of non-monetary assets given in exchange for stocks	2	3%
Approving the external company which determines economic value during a freezeout	3	4%
Other rights		
Freezeout must be at price based on economic value of the company	8	11%
Company has a class of preferred shares that gives special voting rights to its holders when compared to other preferred shares	3	4%

Sample is 74 Brazilian private firms with preferred shares which responded to the 2005 Brazil CG Survey.

We also asked whether the company provides voting rights to preferred shareholders on particular matters. Bovespa Level 2 firms must give preferred shareholders voting rights, together with the common shareholders, for (1) transformation, merger, consolidation or spin-off of the company; (2) approval of conflict-of-interest transactions with a controlling shareholder, if the transaction requires shareholder approval; (3) valuation of non-monetary assets contributed in exchange for shares; and (4) changes to the bylaws which affect the rights of preferred shareholders. Our sample includes 3 firms listed on Level 2, which must provide each of these rights. In addition, a few non-Level-2 firms provide the first two rights. Nine firms give preferred shareholders voting rights on mergers; six do so for conflict-of-interest transactions with the controlling shareholder.

We also asked whether firms provide in their bylaws that during a freezeout, the price paid for preferred shares will be based on the economic value of the company. Eight firms provide this right (11%). This compares with 18 firms (21%) which provide this right to minority common shareholders.

We also asked whether any company had issued a special class of preferred shares which conveys greater voting rights to its holders than other classes of preferred shares. Three companies provide these rights; for one of these, the shares are special *golden shares* retained by the government during privatization.

6.2. Rights of minority common shareholders

We asked whether companies provide for freezeouts to take place at a price based on the economic value of the company and, if so, whether minority shareholders can vote to approve the external company which provides the valuation. Bovespa Level 2 and Novo Mercado rules require both of these rights. Table 16 summarizes the rights of minority common shareholders in freezeouts and sales of control. Ten companies (5 listed on Level 2 or Novo Mercado) require a freezeout offer to minority common shareholders based on economic value. However, only four firms (two listed on Level 2 or Novo Mercado) let minority shareholders approve the company which conducts the valuation.

In a sale of control, the acquirer must offer to buy minority common shares, for at least 80% of the per-share price paid for the controlling shares (100% for Level 2 and Novo Mercado firms). Twelve companies require an offer at 100% of the price paid for control, including the 5 Level 2 and Novo Mercado firms.

6.3. Other minority shareholder rights

6.3.1. Preemptive rights

Preemptive rights are another important protection for minority shareholders. Twenty-five responding firms (29%) do not provide for *authorized capital* (similar to authorized but unissued shares for U.S. firms). For these firms, issuance of shares requires a charter amendment, and minority shareholders will have preemptive rights under Brazilian law. The other 61 responding firms have authorized capital. Of these, 45 provide preemptive rights to shareholders in all cases; another 8 firms do so some of the time. If we combine firms which have no authorized capital and firms which have preemptive rights, preemptive rights are the norm, provided by 70 firms (81%) in all cases, and another 8 firms (9%) in some cases.

6.3.2. Arbitration

Until recently, Brazil did not have specialized business courts. Rio and Sao Paulo have recently created these courts, but the Sao Paulo court is limited to bankruptcy and financial restructuring. The judicial

Table 16
Minority common shareholders: freezeout and takeout rights.

Question	Yes	% Yes
If company goes private, it will make a tender offer for minority common shares, at a price based on the shares' economic value.	10	12%
If yes, the external company which determines economic value must be approved by minority shareholders.	4	40%
Bylaws give takeout rights to common shareholders at 100% of per-share price paid for control.	12	14%

Sample is 86 Brazilian private firms which responded to the 2005 Brazil CG Survey.

process often moves slowly, and most judges have little experience in corporate issues. As a way around problems with the court system, Bovespa requires Level 2 and Novo Mercado firms to provide for arbitration of disputes with shareholders, using the Bovespa-sponsored Market Arbitration Panel. Arbitration is not popular, except as part of a Level 2 or Novo Mercado listing. Only one firm provides for this, in addition to the 5 Level 2 and Novo Mercado firms. Shareholder lawsuits or arbitration complaints are uncommon. Most firms (74 firms; 89%) reports no lawsuits; 5 firms (6%) report one suit, and 4 firms (5%) report two or more.

6.3.3. Free float

Bovespa requires Level 1 and higher firms to maintain at least 25% free float (shares held by minority shareholders/total issue common and preferred shares). This rule is meant to ensure level of liquidity for minority shares. It also prevents a creeping freezeout, in which controllers gradually buy minority shares, which reduces liquidity and hence price for the remaining shares. Fifty-one firms (59%) had at least 25% free float. Fifty-three firms (62%) disclose their free float percentage to shareholders.

7. Related party transactions and executive compensation

7.1. Related party transactions

An important aspect of corporate governance is the extent to which firms engage in related party transactions. Table 17 reports responses to questions about whether these transactions exist, whether they are disclosed, and how they are approved. Bovespa's rules for Level 1 and higher firms require them to disclose related party transactions involving the greater of R$200.000 (a bit over US$100,000) or 1% of the company's net worth.

In practice, only a small number of respondents reported having loans outstanding to related parties (4 firms, 5%), renting property from a related party (3 firms, 4%), or buying or selling significant amounts from or to a related party (7 firms, 8%). So far, so good, although one suspects some underreporting of these transactions. Most firms disclose significant related party transactions to shareholders (59 firms; 69%). It is unclear how to interpret the remaining responses—some firms could have answered no because they have no significant related party transactions to disclosure, rather than because they would not disclose these transactions.

Matters are less satisfactory with regard to approval of related party transactions. We asked separately about transactions with a director or officer, and transactions with a controlling shareholder. Table 17 reports the responses for transactions with the controller; the approval procedures were similar for both groups. One might think that at a minimum, significant related party transactions should be approved by a nonconflicted decision maker—nonconflicted directors, and perhaps nonconflicted shareholders. This is not the norm. Only about two-thirds of the responding firms report that they require board approval. Of the remaining firms, about half had no special procedures for approval of related party transactions.

Table 17
Related party transactions.

	Yes	% Yes
Existence and disclosure of related party transactions		
Has the company lent money to related parties?	4	5%
Does the company rent property from related party?	3	4%
Does the company buy or sell significant goods or services to or from related party?	7	8%
Are details of significant related party transactions disclosed to shareholders?	59	69%
Approval of related party transactions with controller		
No special approval	15	17%
Approval by the board of directors	56	65%
Approval by nonconflicted directors	10	12%
Approval by shareholders	11	13%
Approval by nonconflicted shareholders	8	9%

Sample is 86 Brazilian private firms which responded to the 2005 Brazil CG Survey.

Only 10 firms (12%) report that nonconflicted directors approve significant related party transactions with a controlling shareholder. Eleven firms require shareholder approval, though only 8 require approval by nonconflicted shareholders. Board approval is more common, but many firms have few or no independent directors, so there is no one on the board who is likely to object to a transaction.

7.2. Executive compensation

Our survey provides limited information on compensation of directors and executives. We asked questions about specific levels of compensation, but in contrast to the rest of the survey, many firms did not respond. We did obtain reasonably complete responses to more general questions. Firms rarely use stock options. Only 12 firms (14%) provide them to officers; only two firms provide them to non-executive directors. No firms pay their non-executive directors partly in shares.

8. Disclosure

8.1. Financial statements

We asked firms about a variety of disclosures of financial information which go beyond those required by Brazilian law. For example, Brazilian law does not require a statement of cash flows or quarterly consolidated financial statements (it does require annual consolidated statements). Bovespa requires additional financial disclosure for firms on its higher listing levels. Firms on Level 1 and higher must provide a statement of cash flows. Firms on Level 2 and higher must provide International Financial Reporting Standards (IFRS) or U.S. GAAP financials, and reconcile these statements to Brazilian financial statements; English language financial statements; and consolidated quarterly financial statements.

Table 18 indicates how many firms provide different types of disclosure. Some firms do so as part of compliance with Bovespa rules, but some do so separate from these rules. Almost half (47%) provide English language financial statements; many others are small and attract little foreign investor interest. In addition, 37 companies (43%) include a statement of cash flows and 26 firms (30%) provide IFRS or U.S. GAAP financials. A large majority of companies (83%) provide textual, *MD&A* discussion of their financial results. Some of the firms which provide disclosures that go beyond Bovespa rules are cross-listed, and are complying with cross-listing requirements.

Firms vary in which additional disclosures they provide. For example, of the 26 firms which provide IFRS or U.S. GAAP financial statements, 5 do so to comply with Bovespa rules, 16 to comply with cross-listing requirements, and the remaining 5 do so *other than* in connection with Bovespa or cross-listing requirements. At the same time, only 11 firms reconcile their IFRS or U.S. GAAP financial statements to their Brazilian financial statements. Consolidated financial statements are also not popular. Only 17 firms (20%) provide consolidated quarterly financial statements.

Table 18
Financial statements.

Area	Bovespa rule	Yes	% Yes	Yes not due to listing level at Bovespa
Company provides financial statements in English.	Level 2	41	47%	35
Financial statements include a statement of cash flows.	Level 1	37	43%	14
Company provides financial statements which comply with IFRS or U.S. GAAP.	Level 2	26	30%	20
IFRS or U.S. GAAP financial statements are reconciled to Brazilian financial statements.	Level 2	11	42%	5
Company publishes consolidated quarterly financial statements.	Level 2	17	20%	11
Financial reports include discussion and analysis of factors that most influenced results and company's main risk factors (similar to U.S. MD&A disclosure).		71	83%	
Company officers hold regular meetings with analysts.	Level 1 (annual meetings)	53	62%	

Sample is 86 Brazilian private firms which responded to the 2005 Brazil CG Survey.

A majority of firms (53 firms, 62%) report that company officers meet regularly with analysts. Bovespa requires at least an annual meeting for Level 1 and higher firms. Some firms which do not meet regularly with analysts may have little to no analyst coverage.

8.2. Company websites

We asked whether companies provide different types of information on their websites. Table 19 summarizes the responses, and also whether similar information is available from the CVM website. About half of the firms (40 firms; 47%) have English language disclosure on their websites. Of these, 32 provide English language financial statements. Two-thirds of the firms (58 firms) provide annual financial statements on their website; most of these (51 firms) also provide quarterly financial statements. A similar number of firms provide a written annual report to shareholders. Almost 50% provide press releases.

For shareholder meetings, 36 firms (42%) provide notice of the meeting on the company website; a smaller number (20 firms; 23%) post voting results after the meeting. Finally, 15 firms (18%) have uninformative websites, which contain none of the information we asked about.

9. Control and shareholder agreements

Only one responding firm indicated that it has no controlling shareholder or group. Twenty firms (24%) are directly controlled by a single shareholder. Another 16 are controlled by a non-public company and 5 by another public company, which itself likely has a controlling shareholder or group. Another 10 firms are controlled by a family, 30 by another group of shareholders, and 3 indicated other forms of control.

In some firms, the control group is diffuse enough so that its members find it useful to enter into a shareholder agreement to ensure cohesive voting. Brazilian law facilitates enforcement of these agreements. A shareholder agreement, if filed with the company and made publicly available, is binding on the company. Other shareholder agreements are enforceable between the parties to the agreement, but not against the company.

If a shareholder agreement is filed with the company and made public, votes at a shareholder meeting by control group members, which violate the agreement, will not be counted. In addition, directors elected under a filed agreement must vote in accordance with the terms of the agreement. There is no explicit exception for cases where doing so would conflict with their judgment on what is good for the firm or fair to non-controlling shareholders. Yet a separate, older provision of Brazilian law requires a director to support the company's best interests, “even at the expense of those who elected him.” The tension between these provisions has not yet been addressed by the Brazilian courts. Gorga (2009) studies the specific provisions of Brazilian shareholder agreements.

Table 19
Information on company website.

Process	Yes	% Yes	On CVM website
English language disclosure	40	47%	
Financial and related information			
Annual financial statements	58	67%	yes
Quarterly financial statements	51	59%	yes
Annual report to shareholders	53	62%	
Press releases	42	49%	yes
Stock prices (or link to site with this information)	35	41%	
Shareholder meetings and related information			
Notice of upcoming shareholder meetings	36	42%	
Discussion of the results of shareholder meetings	20	23%	
Background information about board members	27	31%	yes
Other information			
Material changes in facts relevant to share price	51	59%	yes
Other information material to shareholders	48	56%	yes
None of the above	15	18%	

Sample is 86 Brazilian private firms which responded to the 2005 Brazil CG Survey.

Table 20
Shareholder agreements.

	Yes	% Yes
One or more agreement(s) among family or other shareholder group.	36	42%
For firms with a shareholder agreement		
Control is ensured through the agreement(s).	24	67%
The agreement governs the election of one or more directors.	22	61%
The shareholder agreement(s) are registered with the company.	33	92%
Shareholder agreements are not registered with the company, but are disclosed to minority shareholders.	1	33%

Sample is 86 Brazilian private firms which responded to the 2005 Brazil CG Survey.

Table 20 summarizes the responses relating to shareholder agreements. A substantial minority of firms (36 firms; 42%) have a shareholder agreement among the members of the controlling family or group. Of these firms, two-thirds (24 firms) indicated that the shareholder agreement was used to ensure control. Election of directors is a common subject of such an agreement—22 firms indicated that one or more directors were elected in accordance with the agreement; a majority of these firms rely on the shareholder agreement to elect a majority of the board. Of the 36 firms with agreements, 33 (92%) have filed them with the company.

10. Conclusion

In this paper we provide a detailed overview of the corporate governance practices of Brazilian private firms (firms without majority ownership by the government or by a foreign company). The overview is based primarily on an extensive 2005 survey of governance at 116 Brazilian public firms, including 88 Brazilian private firms. We identify areas where Brazilian corporate governance is relatively strong and weak, and areas where regulation might usefully be relaxed or strengthened.

Board independence is an area of notable weakness: the boards of most Brazilian private firms are comprised entirely or almost entirely of insiders or representatives of the controlling family or group. Many firms have zero independent directors. At the same time, minority shareholders have legal rights to representation on the boards of many firms, and this representation is reasonably common.

Financial disclosure lags behind world standards. Brazilian accounting standard do not require either a statement of cash flows or quarterly consolidated financial statements, and only a minority of firms provide these, generally in connection with a listing on Bovespa Level 1 or higher, or cross-listing on a foreign exchange. However, about half of the respondents provide English language financial statements and an English language version of their website.

Audit committees are uncommon. However, many Brazilian firms use an alternate approach to ensuring financial statement accuracy of a fiscal board. Most firms have either an audit committee or a permanent or effectively permanent fiscal board. The relative advantages of audit committee vs. fiscal board, and whether it makes sense to have both require further study.

A high percentage of Brazilian private firms (74 firms, 84%) have issued non-voting preferred shares, as a way for controllers to raise equity capital without diluting their voting control. Brazilian law requires takeout rights for minority common shareholders at 80% of the price paid for controlling shares. A minority of firms goes beyond this legal minimum and provides takeout rights to minority common shareholders at 100% of the price paid for controlling shares, takeout rights for preferred shareholders, or both. Controlling shareholders often use shareholder agreements to ensure control.

Our survey provides a snapshot of Brazilian governance in 2005. However, governance practices in Brazil are changing rapidly, fueled by new IPOs on Bovespa Level 2 and Novo Mercado, and by some older public firms moving to higher Bovespa levels. The number of Level 2 and Novo Mercado firms has grown from 14 at year-end 2004 (5 of which are in our sample of Brazilian private firms), to over 100 firms at year-end 2008.

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