FUNDAÇÃO GETULIO VARGAS

ESCOLA DE ADMINISTRAÇÃO DE EMPRESA DE SÃO PAULO

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The implementation of Corporate Governance in Germany and Brazil: A Comparative Case Study

SÃO PAULO

2014

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Dissertação apresentada à Escola de Administração de Empresas de São Paulo da Fundação Getúlio Vargas, como requisito para obtenção do título de Mestre Profissional em Gestão Internacional.

Campo do Conhecimento:
Governança Corporativa

Orientador Prof. Dr. Servio Tulio Prado Junior

SÃO PAULO

2014

Kohlmann, Patrick. The implementation of Corporate Governance in Germany and Brazil: A Comparative Case Study. Patrick Kohlmann. 2014. 71 pages

Orientador: Servio Tulio Prado Junior

Dissertação (MPGI) - Escola de Administração de Empresas de São Paulo.

1. Governança corporativa - Brasil. 2. Governança corporativa - Alemanha. 3. Natura (Firma). 4. Beiersdorf. 5. Administração de empresas. I. Prado Junior, Servio Tulio. II. Dissertação (MPGI) - Escola de Administração de Empresas de São Paulo. III. The implementation of Corporate Governance in Germany and Brazil: A Comparative Case Study.

CDU 65.012.432

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Campo do Conhecimento:
Gestão e Competitividade em Empresas Globais

Data de Aprovação:
___/___/____.

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Acknowledgments

I would like to thank all the people who I met during my studies at FGV, ESADE and St.Gallen. I would like to devote special thanks to my family, my girlfriend and my friends who constantly gave me unbelievable amount of support. Lastly, also would like to thank all my professors, who broadened my views in so many different topics.

Thank you all,

Abstract

The recent promotion of best corporate governance standards by several different government institutions and non-for profit organizations resulted in the implementation of more sophisticated governance mechanisms. As consequence to the separation of ownership and control the concept of agency theory arose. Agency theory argues that without out proper control mechanism managers would behave exploit owners due to information asymmetry. Regulators have promoted corporate governance mechanisms in order to address this issue. This paper aims to contrast the implementation of best corporate governance practices in Germany and Brazil on the example of two practical examples.

With this purpose in mind, this paper analyzed two companies listed in the main stock exchange in Germany and Brazil throughout a period of 5 years. In order to measure the degree of corporate governance practices implemented 3 different parameters have been chosen. In line with great part of the literature the parameters considered to be relevant are; composition, procedures and deviation from the local corporate governance code.

The comparison of the data revealed that board composition in the two analyzed companies is similar regarding the proportion of independent representatives but does distinguish in size. While committees are related to the same topics it can be implied that Natura's board is more involved in the actual management of the company. Lastly, Beiersdorf has been able to comply to a larger extend with the recommendations of the local German code than Natura to the recommendations published by Brazilian code of the IBGC.

Key Words: Corporate Governance, Germany, Brazil, Beiersdorf, Natura

Resumo

A recente promoção de melhores práticas de governança corporativa por diversas instituições governamentais diferentes e organizações sem fins lucrativos resultou na implementação de mecanismos de governança mais sofisticados. Como consequência da separação entre propriedade e controle surgiu o conceito de "Agency Theory". A teoria argumenta que, sem um mecanismo de controle adequado, gestores explorarão proprietários, devido à assimetria de informação. Vários reguladores têm promovido mecanismos de governança corporativa, com o objetivo de resolver esta questão. Este trabalho tem como propósito comparar a implementação das melhores práticas de governança corporativa na Alemanha e no Brasil incluindo dois exemplos práticos.

Com esta meta em mente, este trabalho analisou duas empresas cotadas na principal bolsa de valores da Alemanha e do Brasil ao longo de um período de 5 anos. Para medir o grau de práticas de governança corporativa implementado, três parâmetros diferentes foram escolhidos. Em sintonia com grande parte da literatura sobre este tema, os parâmetros considerados relevantes são: composição do conselho de administração, procedimentos do conselho e desvio do código de governança corporativa local.

A comparação dos dados analisados revelou que a composição do conselho nas duas empresas analisadas da Alemanha e do Brasil são semelhante em relação à proporção de representantes independentes, mas fazem uma distinção no tamanho do conselho. Embora os conselhos das duas empresas estejam envolvidos nos mesmos temas, fica implícito, e que o conselho da Natura está mais envolvido com a efetiva gestão da empresa. Por último, a Beiersdorf foi capaz de cumprir a maior parte das recomendações do código local Alemão em comparação com a Natura que cumpre uma parte menor das recomendações publicadas pelo código Brasileiro do IBGC.

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1. Introduction

Weinstein (2012) argues that during the last 30 years the power structure and management principles of corporations were designed based on the concept of corporate governance and the particular influence of the agency theory. The origin to promote best corporate governance practices comes with the problematic relationship between shareholders und managers. According to the agency theory, information asymmetry results in deviations from value maximizing behavior by managers. The result was to either implement proper control mechanism or to align interest of both parties (Dalton, Hitt, Certo & Dalton, 2007).

The aim of this paper is to conduct a comparative analysis of corporate governance implementation in Germany and Brazil based on two practical examples. The motivation for investigating this topic comes firstly, from the recent development in the corporate governance mechanisms in both countries. In Brazil, the Brazilian Securities and Exchange Commision (*Commissão de Valores Mobiliarios*) and the IBGC (*Instituo Brasileiro de Governance Corporativa*) recently has been promoting best corporate governance practices among Brazilian listed companies. In Germany, the German corporate governance code has increasingly impacted the governance structure of listed companies. Furthermore, the author's professional involvement in the IBGC as member of the German Corporate Governance Group reaffirmed my motivation to address this topic. The ultimate question that this paper is determined to answer is: How does the implementation of corporate governance practices may differentiate in Germany and Brazil?

In order to compare the implementation, two companies in each country have been selected and analyzed throughout a period of 5 years. The companies Natura and Beiersdorf have been chosen because both are considered as reference in corporate governance practices in their respective stock exchange. To measure the extent to which best practices have been implemented, 3 parameters have been identified: board composition, board procedures and the deviation from recommendations of the local corporate governance code.

This paper firstly provides an extensive literature review including the topics agency theory, corporate governance in Germany and corporate governance in Brazil. Secondly, the methodology explains how the comparison is made, what kind of data is used and the results of the data obtained. Lastly this paper addresses possible limitations and suggestions on future research.

2. Literature Review

2.1 Agency Theory

Agency theory has been a controversial topic of the academic business arena and subject of constant research for the last 30 to 40 years. The first foundations of this theory were laid by Adam Smith in his Masterpiece “An Inquiry into the Nature and Causes of the Wealth of Nations” written in the 18th century. Smith already acknowledged that professional managers would not behave in the same way enterprise owners would. This hypothesis already laid the fundamental stone for the agency theory. Later Berle and Means (1932) pointed out that in modern times, due to the diminution of ownership, the control and management duties of large corporations were transferred from owners to professional managers.

Agency theory describes the problematic relationship that occurs in organizations in which one or more persons (the principals) engage another person (the agent) to act on behalf of them (Jensen & Meckling, 1976). This, as mentioned before, came with the general trend that businesses passed from private owners to a much more dispersed market ownership that consequently led to the separation of ownership and management. Thus, this separation explains the agency problem; if both parties act on their best own interest this will naturally lead to the agent not always acting in the best interest of the principal. Even though both parties want to improve firm performance they still have partly different goals and risk preferences (Eisenhardt, 1989). In other words, the agency theory describes the mismatch of interests between company’s equity holders and the company’s professional management. As any organization is tied into a series of contracts and the sum of the contracts

organize the “rules of the game” between all different stakeholders, the principal-agent problem arises with the fact that the principal in most cases cannot closely observe if the agent is behaving accordingly and fulfilling the contract (Fama & Jensen, 1983; Eisenhardt, 1989). Fama and Jensen (1983) furthermore argue that “agency problem arises when the decision managers who initiate and implement important decisions are not major residual claimants and therefore do not bear a major share of the wealth effects of their decision” (Fama & Jensen, 1983, p.302).

A common obscurity comes with the issue of understanding why principals need to hire agents in the first place. The literature argues that the need for agents comes with the simple belief that agents (managers) serve as professionals with unique strategic knowledge, which is crucial for the efficient allocation of limited corporate resources (Westphal & Zajac, 2013). In the case of Agency theory as mentioned before the “principal” would refer to the company’s shareholder and equity holder, who then appoints the management or “agent” with its unique strategic knowledge to direct the organization in best manners.

In order to resolve the agency problem, researchers argue that effective control procedures have to be implemented to guarantee that decisions makers are more likely to take actions that are in line with the interests of owners. Nyberg (2010) identified agency costs as the result of the mismatch of interests between the principal and the agent. Therefore they would occur when managers advance in their personal interest at the expense of the shareholders (Westphal & Zajac, 2013). Agency costs would primarily include the risk of shrinking firms, perquisites consumption and other opportunistic behavior by agents, which would ultimately lead to the devaluation of the firm. The increase of agency cost arises mainly because of asymmetric information and the fact that there is a lack of goal congruence between principal and agent (Nyberg, 2010).

As a result Dalton, Hitt, Certo & Dalton (2007) identified three means of minimizing agency costs. Firstly, the authors argue that the composition of the board of directors plays a fundamental role in the reduction of agency costs. The composition of any

board most essentially is driven by board independence and the leadership structure of the board. While leadership structure concerns' itself with the role of the chairman, the committees and the role of the CEO, board independence is referred to by the proportion of independent directors making part of the board of directors. Both are seen as important factors of corporate governance, which are fundamental in the proper monitoring of the management of any given company.

Perhaps the most discussed area in corporate governance research, which is associated with reducing agency costs, comes with equity ownership. Jensen & Meckling already realized in 1976 that financial alignment could be an effective instrument that aligns managerial preferences and actions in a way that agency costs are reduced. According to this theory, alignment should be created by either equity ownership of executives or by adjusting compensation policies to be dependent on changes in shareholder wealth. There is no doubt that in recent years this has increasingly gained popularity also outside the academic arena. Mainly in form of stock options which today commonly make part of most compensation policies of stock corporations all around the world.

A further area that has been referred as mechanism to reduce agency cost comes with the market of corporate control, which argues that efficient markets will correct self-interested behavior through mergers and acquisitions. Thus, this would mean that corporations with agency issues that have suffered from poor governance would naturally devaluate in the equity market. This would catch the attention of other firms, which would recognize the undervaluation and sense an opportunity. As stock prices would decline the company would be an attractive target and as well be vulnerable to hostile takeovers. Lastly after acquiring the target company with a discount, the new owners would install proper management and governance structures and finally re-boost the value of the firm. However this mechanism only steps in after all other governance mechanisms have failed and the devaluation of the firm already has occurred.

However, there is no ultimate guarantee or even a correct approach to eliminate agency costs. There are no means to completely guarantee that managers will make optimal choices no matter what. Therefore in reality the complete elimination of agency costs is practical impossible (Nyberg, 2010).

There is also no doubt that traditional agency theory somehow lacks the connection to a more behavioral approach to corporate governance. The argument behind this is that corporate leaders and directors not only take decision based on information, personal risk preferences and self-interest but that managers and directors, like all other individuals, find themselves in a set of social relationships, networks and institutions and thus take decisions also based on there individual social environment and believes (Westphal & Zajac, 2013). Furthermore behavioral governance argues that socio-political processes have a significant impact on the governance structures of any given firm (Westphal & Zajac, 2013). This aspect should also highlight the importance of soft relationships between management and the board of directors (social ties). Of course an behavioral approach should not replace the agency theory, but emphasize that any social relationship within different individuals of the Board of directors, the management board and any other stakeholders (employees, journalist or even analysts) may have an significant influence on the behavior of directors and managers of a firm. Furthermore Westphal and Zajac (2013) highlight that it is common for corporate leaders to engage in social influence tactics and other political actions in order to guarantee the satisfaction of their personal interest.

Critics have identified several limitations to the agency theory. Especially the fact that it is mainly applicable to large, for profit enterprises with mature capital markets and a diffuse base of shareholders serve as weak spots. Accordingly, the majority of businesses operate in an environment where agency theory is less relevant (Lubatkin, 2005). But also the circumstance that the agency theory model simplifies assumptions about the nature of individuals, organizations, and markets has been criticized (Daily, Dalton & Cannella, 2003; Lubatkin, 2005).

Furthermore Dalton, Hitt, Certo & Dalton (2007) highlight that the broad body of agency theory literature so far, hasn't been able to agree and provide clear evidence that any interventions (board composition, market of corporate control and equity ownership) have actually a significant effect in reducing agency cost and consequently a positive effect on firm performance. For example according to Schalka (2012) who studied the Brazilian market, an increase of the percentage of outside directors or an increase of institutional ownership might actually lead to worse firm performance. This supports the theory that "better" governance not necessarily leads to better performance. In conclusion, the literature leads to the assumption that it is much more the environment and the particular situation a company is facing that determines what corporate governance mechanism will, or not, be beneficial to the performance of any company.

2.2 Corporate Governance in Germany

In contrast to the Anglo Saxon movement of having a one tier Corporate Governance System with one board of directors, in Germany the law of 1870 already created the two-tier board system to protect small shareholders and the public from self-serving managers, with the establishment of two separate boards. One the one hand; the supervisory board and on the other hand the management board. A dual board system means that the leadership structure of an organization is divided between the management board, an executive organ, and the supervisory board that monitors the management. The early laws did not provide clear separation of responsibilities and thus resulted in the supervisory board technically having significant influence on executive matters. However the decrease of concentrated ownership in the early twentieth century and the legal boundaries to the supervisory board resulted in the concentration of power in the management board of big corporations in Germany (Morck & Steier, 2005; Grundei & Zaumseil, 2012). The new corporation act of 1937 redefined the responsibilities of both boards and formally strengthened the position of the management board, limiting the supervisory board to a complete supervisory organ (Grundei & Zaumseil, 2012). During the Hitler regime German corporations experienced a concentration of power at the executive level. But at the same time they replaced the duty to serve in the interest of shareholders with a general duty to all stakeholders and to the *Reich* (Morck & Steier, 2005). To some extend the shareholder-stakeholder conflict remained a German characteristic until today and is constant subject to German academic discussion (Roth, 2010). A further effect of the Second World War and the allied occupation would result in the introduction of the concept of co-determination at board level, a German corporate governance particularity, which will be explained later in this paper.

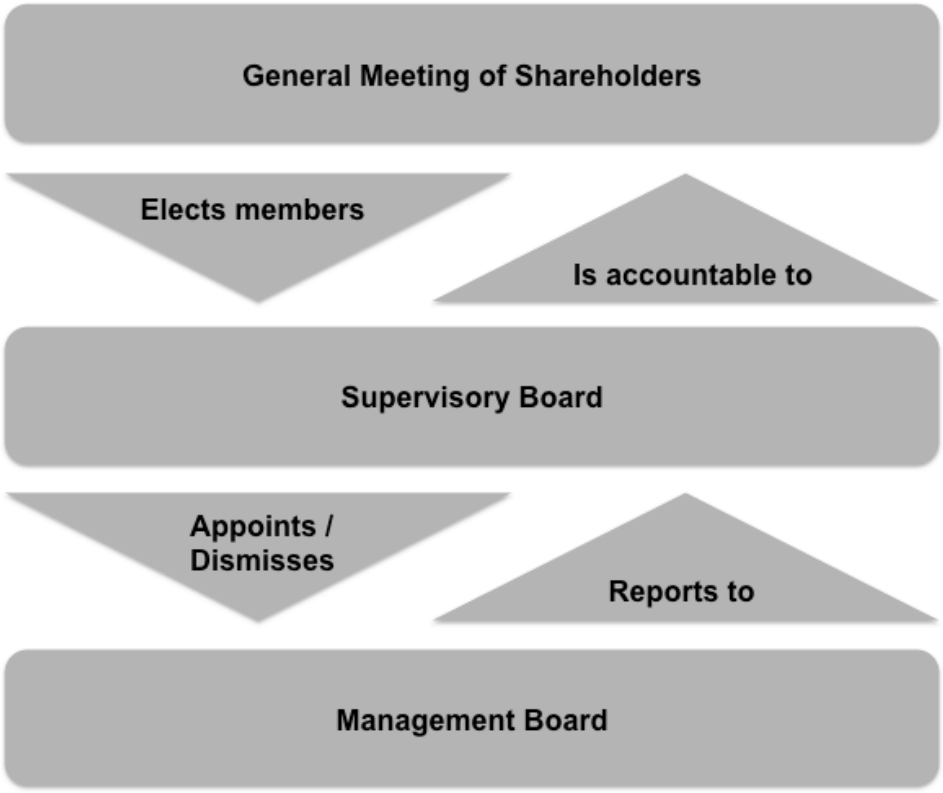
After the allied occupation and as a consequence of the German stock corporation Act of 1965 the German law (re) introduced a dual board system for all German stock corporations (Jungmann, 2006). The dual system completely separates management and supervision (Grundei and Zaumseil, 2012). In its basic function the

supervisory board is responsible for supervising, appointing/dismissing and lastly advising the management board. On the other side the management board is accountable for the actual management of the enterprise. The distinctive mark of the dual system is the personal and functional separation of management and control. In other words this would also mean that the supervisory board ideally serves as monitoring organ and “sparring partner” while the management board undertakes daily management & operational activities (Ginthor, 2005).

The general meeting of shareholders, also regarded as the highest corporate organ (Jungmann, 2006), elects the members of the supervisory board. The elected supervisory board then has the responsibility to act as an independent supervisory organ to the management board. It is also important to note, that no individual shareholder has the authority to give instructions to the supervisory board and thus the board in general has to act in the best interest of all shareholders. Consequently this means that the general meeting of shareholder is restricted to taking some fundamental decisions on company matters described later in this work. Essentially the general meeting’s influence is limited to the election of the supervisory board. The supervisory board in a second step also has no direct authority to give directives to the management board and therefore the management board acts autonomously and independently. However the power of the supervisory board lies in the right to dismiss and to appoint members of the management board. The representation of the company to third party lies in the responsibility of the management board. The management board has moreover the obligation to supply the supervisory board with the according business reports and regularly give detailed information on the situation of the company (Grundei, 2012).

The following graphic should help to illustrate the German corporate governance construct:

Figure 1: Structure of German Corporate Governance



Source: Elaborated by the author

2.2.1 Legal Framework

The two most common legal forms of companies in Germany are the GmbH (*"Gesellschaft mit beschränkter Haftung")* and the AG (*"Aktiengesellschaft").* The AG typically comparable with the American stock corporation is more suitable for large publically firms with diffuse ownership that typically would trade their shares on a stock exchange. However of the around 17.000 AG's in Germany only 900 are listed (Bdi.eu, 2013) which implies that the majority is still in private hands. The GmbH in contrast is a private limited company, which in most cases is family owned and cannot be listed on a stock exchange. With 1.100.000 GmbH's in Germany the limited company is also among the most preferred legal forms for incorporation (Müller and König, 2011).

German law foresees a dual board system for German stock corporations (*Aktiengesellschaft*). In contrast to that, the limited liability Company Act (GmbHG) does not necessarily require a supervisory board for companies incorporated as limited corporations (*Gesellschaft mit beschränkter Haftung*). Thus, for listed stock corporations, which are the focus of this paper, the ”*Aktiengesetz*” gives the legal framework, in which it defines how the supervisory board and management board should operate (AktG). As mentioned before, a dual board system is defined by complete separation between management activities and supervisory activities. As a result a membership in one of the board would automatically prohibit a membership on the other board of the same company by law (Jungmann, 2006).

The management board mainly is responsible for managing the day-to-day business of the company. The German Corporate Governance Code correctly states that the members of the management board are jointly accountable for the general management of the enterprise. The management board should decide on the future strategy, on profitability measures, on appropriate risk management and other operational issues (Pierce, 2010). In general, the management board is headed by the CEO (“Vorstandsvorsitzender”) or commonly also referred to as; the chairman of the management board, who is responsible for the coordination of the work of the members. Another important characteristic of the management board is that it acts completely autonomously and therefore is not bound to any orders neither by the general meeting of shareholders nor by the supervisory board (Jungmann, 2006). However it is appointed by the supervisory board, which also has the right to dismiss any members for good cause (Davies, Hopt, Nowak & Solinge, 2014). The annual (consolidated) financial statements (and the annual report) are also responsibility of the management board, which then have to be examined by the supervisory board and the auditor before reaching the shareholders (German Corporate Governance Code, 2013; Page, 2001). Regarding the number of executives on the board the German law gives companies freedom and foresees no specific regulation. The appointment of members of the management board is limited to a five-year period. Members of the board may be reappointed after their term ended. §76 AG also

states, that management is obliged to take all stakeholders (employees, creditors, debtors, etc.) into consideration when taking decisions. This again somehow reflects general German attitude that business organizations do not exist to exclusively serve in the interest of investors (shareholder – stakeholder conflict). The co-determination aspect, a major result of this attitude will be explained and commented later in this work.

The supervisory board on the other hand is solely responsible for the supervision of the management board. The supervision activities among many others include appointing, dismissing, monitoring and advising the members of the management board. Moreover the supervisory board should be included in the decision making process of fundamental importance to the enterprise. The appointment of the management board is carried out on basis of a majority decision by the supervisory board (Page, 2001). The individual members of the supervisory board are elected by the general meeting of shareholders, either by proposal of the current supervisory board or directly by proposal of the shareholders (Grundei & Zaumseil, 2012). An exception is made to the members who represent the co-determination regime of a company. As mentioned, the co-determination aspect of German corporate governance will be explained in more detail in a later chapter of this paper. All activities of the supervisory board are coordinated by the chairman, who is elected by a majority of two thirds of the members of the supervisory board (German Corporate Governance Code, 2013; MitbestG §27). In case of split resolution the chairman of the board has the casting vote (Pierce, 2010). Moreover the supervisory board also is responsible for fixing the amount of remuneration for the members of the management board. A further responsibility of the supervisory board lies in the proposition of the auditor to be appointed by the general meeting. For any dismissals of members of the supervisory board, the general meeting or the court holds the responsibility. The number of supervisory board members is limited to a minimum of 3 and a maximum of 21 members which also highly dependent on the co-determination aspect of a given company. The term of members is in general limited

between four or five years. The remuneration for members of the supervisory board is fixed by the general meeting (Baums and Birkenkaemper, 1998).

A further restriction made by the German law to members of the supervisory board comes with the number of supervisory board seats an individual can hold in different companies. In order to guarantee that directors will dedicate sufficient amount of time the law limits the maximum number of seats in different supervisory boards hold by an individual to 10. The chair position counts as two seats, meaning that the maximum of chair position one can hold is limited to 5 (du Plessis, Großfeld, Luttermann, Sandrock & Casper, 2012). Exceptions come with seats that are hold in-group companies of a holding company (AktG).

The supervisory board may also set up certain committees of the board. The main reason the application of committees lies in the purpose of handling complex issues with more efficiency (Davies, Hopt, Nowak & Solinge, 2014). The designated committees chairmen report directly to the supervisory board.

The general meeting of shareholders has the primary right to elect its representatives to the supervisory board. Thus this means that the shareholder representatives of the supervisory board have the obligation to act in the best interest of the shareholders. Additionally the general meeting of shareholders formally approves of actions taken by either management board or supervisory board. However the law provides an exception; if the management board request their involvement, it may decide on regular management issues (Baums and Birkenkaemper, 1998). Also as mentioned briefly before one of the topics covered by the general meetings is also the appointment of the auditor proposed by the supervisory board (Davies, Hopt, Nowak & Solinge, 2014). Lastly, within its field of responsibilities also lies decision-making regarding the articles of incorporation and the disposal of profits (Page, 2001).

2.2.2 German Stock Markets

The German financial market place is dominated by the *Deutsche Börse* Group, a leading worldwide exchange organization. The popular Frankfurt stock exchange is operated by the deutsche Börse Group, who among other things also owns and operates the Eurex, a German derivatives exchange. The Frankfurt stock exchange is by far the most important unit among their portfolio. Additionally, they also operate the famous German blue chip index; DAX, which also has three parallel sub-indexes, the MDAX, the SDAX, the TecDAX (Deutsche-boerse.com, 2014).

The city of Frankfurt was already considered an important point of encounter and trade in medieval times and consequently developed itself into a meeting place for merchants from all Europe. Due to the difficulties of trading in several different coins and currencies, merchants established uniformed exchange rates in 1585, regarded as the birth year of the Frankfurt exchanges (Deutsche-boerse.com, 2014). Today Frankfurt established itself as the most important trading center in Germany and is among the top 10 financial centers worldwide (by domestic market capitalization) (World-exchanges.org, 2014).

For the German financial markets the DAX is the most relevant index as it is composed of the 30 major German stock corporations. Some globally known companies under the DAX include BMW, Adidas, Volkswagen, Siemens and Beiersdorf just to name a few. The MDAX index includes 50 shares of German companies that rank after the DAX in terms of market capitalization and order book volume. Lastly the SDAX includes small and midsized companies who rank after the MDAx as well by market capitalization and book volume (Deutsche-boerse.com, 2014).

Another interesting evolution was the introduction of the *Neuer Markt* at the Frankfurt exchange. Originally to resemble the famous American NASDAQ. The *Neuer Markt (NEMAX)* was a segment of the Frankfurt stock exchange, which opened in 1997 as response to the strong demand in young high-tech companies. The basic idea behind this was to offer a platform for venture capital & private equity firms to collect

public equity. In the German financial market it was supposed to have a very similar role to the Nasdaq in the USA. Moreover the *Neuer Markt* pushed transparency requirements in order to boost investor's confidence. As consequence to the dot.com bubble in 2001 the *Neuer Markt* was closed down and later on replaced by the TecDAX (Kalkreuth & Silbermann, 2010).

In general, the Frankfurt stock exchange does not distinguish between different corporate governance requirements.

2.2.3 Ownership Structure

During the last century, and especially because of the unique historic path of Germany, the ownership structure in Germany experienced significant changes. Before the First World War the German stock market was very mature, developed and disperse compared to other markets in different developed economies around the world (Davies, Hopt, Nowak & Solinge, 2014; Morck & Steier, 2005). However after the First and Second World War and during the rebuilding of Germany, the ownership structure of German companies was on the one hand dominated by the so-called "*Hausbanken*" and on the other hand by block holders. "*Hausbanken*" were referred to as local banks that had significant influence on the control of corporations. The result was the development of the "Deutschland AG", translated in english: the German Inc., which was mainly characterized by strong cross ownership networks (Fehre (2011). This ultimately meant a relatively high concentrated ownership model at the major German stock corporations. Besides the "*Hausbanken*", especially the major financial intuitions (Allianz, Munich Re and Deutsche Bank) played a very active and important role in the German Inc. corporate governance system (Davies, Hopt, Nowak & Solinge, 2014).

As mentioned, a distinctive characteristic of the German economy was cross ownership. Until 1990 it was common for Germany companies to have significant investments in other German companies. As a result of this cross ownership structures it was also common to see strong network of personal ties among the

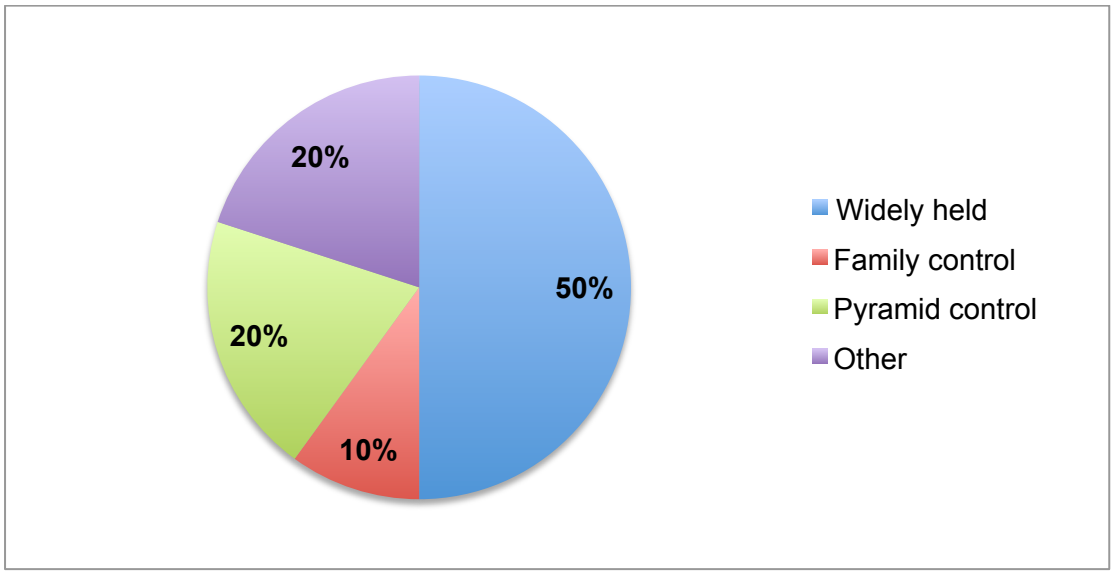
largest companies of the country, especially at the level of supervisory boards and management boards. However, since the 1990's and to some part as result of globalization, these constructs haven been constantly disappearing more and more. Today, Germany companies at least to some extend have dispersed ownership structures and a high proportion of foreign institutional investors. But the traditional presence of family ownership still remained a German characteristic and marks the ownership of the major German listed corporations. Davies, Hopt, Nowak & Solinge (2014) point out that one third of the DAX is still owned by families and foundations.

Pierce (2010) highlights that German listed companies have high concentrated share ownership, which usually is associated with large block holders having the advantage to have significant influence on the decision making at corporate level. In addition it is true that the equity market is relatively small compared to other developed market economies such as the USA and the UK. In general, the market capitalization in Germany is relatively low compared to its GDP (Data.worldbank.org, 2014).

Weber (2009) also recognized that Germany shows characteristics of high ownership concentration and argues that this has been the result of the co-determination system, which requires investors to have large shareholdings in order to assure themselves attractive returns and significant control. Dominant shareholders or block holders to some extend help to solve the agency problem, as they have more power to discipline and oversee management properly. But on the other side this also comes with a downside for minority shareholder, especially when their interests are not aligned with those of block holders (Enriques, 2007).

In his study, Fehre (2011) also points out the development of free float among stock corporations, found that the free float of German large caps increased from 65% in 1997 to 75% in 2006. In addition to that Fehre (2011) also shows that on average the ownership of block holders decreased from 35,96% in 1997 to 24,83% in 2006. He furthermore concludes from this that this has been a result of good corporate governance standards that has substituted block holders in the respective years.

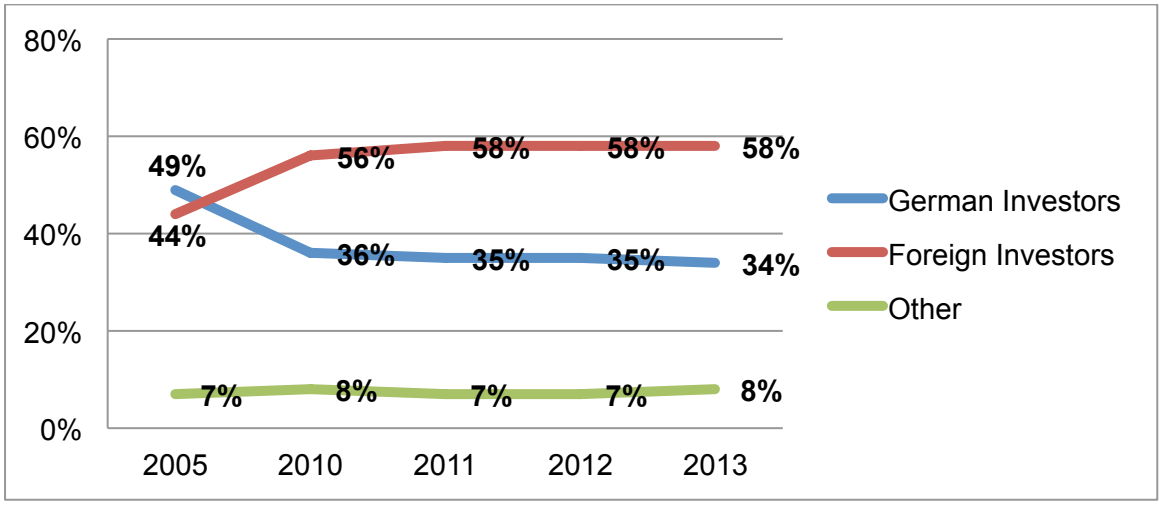
Figure 2: Controlling Shareholders in Germany



Source: (Enriques & Volpin, 2007)

Enriques & Volpin (2007) highlight that among the 20 largest listed stock German corporations about the half show no controlling shareholder (no individual shareholder with more than 20% of the voting right). Of those 20 companies, 10% have families as a controlling shareholder and further 20% have another listed corporation (pyramid control) as controlling shareholder. Another 20% of the largest 20 companies do have an unidentified controlling shareholder. A typical way of holding control of companies in Germany is building up pyramidal ownership. Shareholders use the pyramid ownership construct in order to exercise control through another different listed company. A perfect German example of pyramid ownership would be the Porsche Family holding control of Volkswagen AG through Porsche AG.

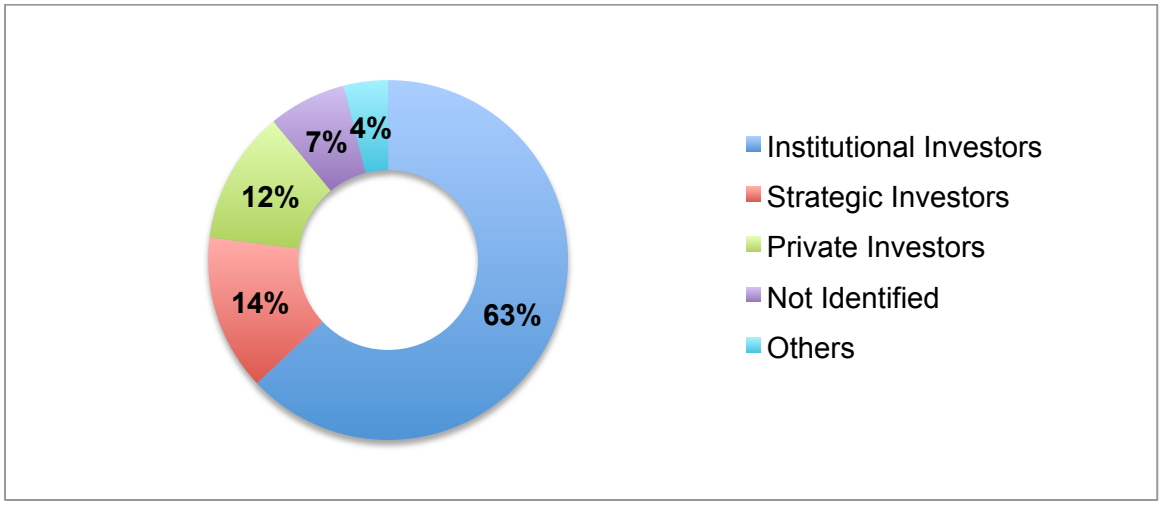
Figure 3: Foreign & German Investors



Source: (Braunberger, 2014) F.A.Z.

A recent study elaborated by E&Y and published in the German newspaper F.A.Z. shows that in the last years the proportion of foreign ownership in the German stock corporations has increased significantly. German investors traditionally have been risk adverse preferring conservative investments (not in the equity market).

Figure 4: Who holds shares in Germany



Source: (Braunberger, 2014) F.A.Z.

A second graphic in the article demonstrates the ownership structure by different investors in Germany, indicating that the majority of shares in the German financial

markets are hold by either institutional investors or by strategic investors. The graphic once more draws the attention to the fact that German private investors do not commonly invest in company stocks.

2.2.4 German Corporate Governance Code

After the OECD passed the “OECD principal of Corporate Governance” in 1999, a debate about developing standards of best practices in Germany was unleashed. Already in the year 2000 the Initiative group presented a first version of the German Code of Corporate Governance. This was done after Chancellor Gerhard Schröder established a particular government commission in order to tackle deficits of the German corporate governance and supervision system. The first official version of the Code was published in 2002 while the commission continues to exist in form of standing commission pursuing the constant development of the code (Rosen, 2007).

The Code distinguishes between recommendations and suggestions. While enterprises have to comment and record any deviations of recommendations, deviations from suggestions do not have to be commented. This serves the purpose that companies explain deviation from more important matters, while deviations of suggestions can be left uncommented (Rosen, 2007). Furthermore, the code has no direct legal force. It is rather defined by a soft law character where it contains the legal obligation for a certain company to “comply or to explain” (Hirte, 2007). This in other words means that it is left to the companies’ management and supervisory board to comply with the code or not. However, in case certain recommendations are not complied, the organs have to include a declaration which recommendations have not been complied. Regulated by the law this declaration has to be published once a year either on the Internet page and/or in the annual financial statements (Rosen, 2007).

The latest German Corporate Governance Code of 2013 divides its recommendations and suggestion into six areas:

1. Shareholders and General Meeting

2. Cooperation between Management Board and Supervisory Board
3. Management Board
4. Supervisory Board
5. Transparency
6. Reporting and Audit of the Annual Financial Statements

The first area enforces the rights of the shareholders, especially during the general meeting. It makes recommendations regarding voting circumstances and voting rights, essentially facilitating shareholders to express their opinion and vote accordingly.

The cooperation between management and supervisory board should be organized in such way that guarantees the greatest benefit to the organization. This area highlights the importance of information flow between management board and supervisory board. It makes suggestions and recommendations regarding meeting between both boards and meeting without the other board. It also gives some information on best practices in case of a takeover offer. One of the recommendations of the code in this are include the compilation of a Corporate Governance Report.

The third chapter of the code makes comments on the task, responsibilities, composition and compensation of the management board. Furthermore it includes a part, which highlights potential area of conflicts for the management board. While emphasizing the importance of the sustainable management of the enterprise, the code also comments on the composition of the board where it promotes diversity in the management board. Regarding compensation of the management board the code makes clear that compensation has to be appropriate, transparent and of course take into account the performance of each individual member of the management board. It closely comments on how to structure executive compensation and emphasizes a variable as well as a fixed component of the overall compensation. Finally it the code draws attention to conflicts of interest of members of the management board, once again making sure that executives act in best

interest of the company (including a non-competition obligation, disclosure of sideline activities…).

Similar to the previous parts, chapter 4 describes the role of the supervisory board in German corporate governance. It once more emphasizes the characteristics of the dual board system where the supervisory board mainly is concerned with the supervision of the management board. But it should also act as an advisor to the management board and therefore be involved in decision of fundamental importance to the company. One interesting aspect in this part is the recommendation that the chairman of the supervisory board shall not be the chairman of the audit committee. Another point that the code suggests is the formation of committees, which have their focus in investigating certain matters and require special expertise of its members. Regarding the composition of the board of directors the code emphasizes the importance of independent board members. This is completely in line with great part of the literature that emphasizes the importance of independent directors in good corporate governance (Daily and Dalton 1992; Peng, 2004; Petra, 2005; Barnhart, Marr & Rosenstein 1994; Rosenstein & Wyatt, 1990; Schellenger 1989). However, the code remains unspecific and does not recommend a clear number of independent members on the board. The code furthermore gives the recommendation in case of transition from the management board to the supervisory board; members should not go through a direct transition. Instead it foresees a two-year period in-between, after which a former member of the management can become active as member of the supervisory board.

The fifth section of the code occupies itself with the transparency issues within the corporate governance domain. The supply of corporate information for shareholder is a key issue in this section, where it argues that the treatment of all shareholders should be equal. Apart from that, this section also covers a recommendation for a financial calendar where important dates are published and a recommendation for the disclosure of ownership (above 1%) by the supervisory or/and management board.

The last section is devoted to issues of reporting standards and the attributes of the annual financial statements. It describes the periods of reporting and also emphasize that consolidated financial statements have to be published under observance of internationally recognized accounting principles. The recommendations include a certain time frame within the reports should be published. The code also recommends a list of third party companies where a given company acts as a shareholder. At last, it describes the ideal relationship between the auditor, the supervisory board and the management board.

Major points of the code include:

→ The Code stresses the importance of close cooperation between management board and supervisory board.

→ Gender diversity has been an important topic in the code, where it emphasizes the not only gender diversity but diversity in general.

→ The establishment of an audit committee and if needed an nomination committee

→ Independence of directors has not been a focus mainly because of the dualistic system. No specific number or proportion of the board.

→ No recommendation or suggestion is done regarding the number of meetings.

2.2.5 German Characteristics

Managerial Co-determination ("*Mitbestimmung*") is one of the most German related corporate governance topics, which has an immediate effect on the management and supervision of German companies. "The co-determination law guarantees employees participation in the regulation of working conditions as well as in economic planning and decision making" (Page, 2001, p11.).

The basic origins of co-determination were already developed back in the 1920's and today it practice takes place at two levels; the works council ("*Betriebsrat"*) and trough its representation in the supervisory board (Page, 2001). Its basic justification comes with the believe that an individual employee has not the bargaining power to defend his/her interest at an equal position to the employer. As a result, the German law prescribes a woks council, where the interests of the employees are represented (Page, 2001). Roth (2010) describes the concrete movement towards employee protection at the beginning of the twentieth century in Germany as the enterprise per se movement ("*Unternehmen an sich*"), which moved away from the traditional view of the corporation acting in the interest of the shareholders towards companies that at the same time act in the interest of employees and creditors(shareholder – stakeholder conflict). The first forms of co-determination were introduced in the early twentieth century but became legally relevant with the Act on Deployment in 1922 (Roth, 2010). The Nazis however abolished co-determination and empowered executives during their regime. After the Second World War and also as consequence to the occurrences, British influence combined with German trade union pushed the (re) introduced and strengthened the concept of co-determination (du Plessis, Großfeld, Luttermann, Sandrock & Casper, 2012).

The German law does not require employee representation at the supervisory board for companies with 0-500 employees. For companies with a total number of employees between 500 and 2.000 in Germany, co-determination law is applicable as long as they are not companies with ideological or religious orientation. Thus co-determination applies for limited liability companies, stock corporations, and any

other kind of family enterprises. For companies who fulfill these criteria the supervisory board is to be represented by 1/3 from its employee representatives. The overall size of the board is still specified in the statue. However it must be divisible by three in order to have the appropriate proportions. This means that technically the size of the supervisory board can very from 3 to 21 members. In general, all employees of the enterprise elect their representatives to the board (Page, 2001). However in some cases the trade union can nominate members to the board. The co-determination act of 1976 defines the structure for corporation with more than 2000 employees. The composition of the board should in this case be made of 50% of employee representatives. Depending on the numbers of employees the supervisory board should be composed to these criteria:

Table 1: Co-determination on German supervisory boards

Number of employees	Shareholder and Employee representatives
500 – 2.000	2/3 shareholders reps. & 1/3 employee reps.
2.001 - 10.000	6 shareholder reps. & 6 employee reps.
10.001-20.000	8 shareholder reps & 8 employee reps.
20.001 and more	10 shareholder reps & 10 employee reps.

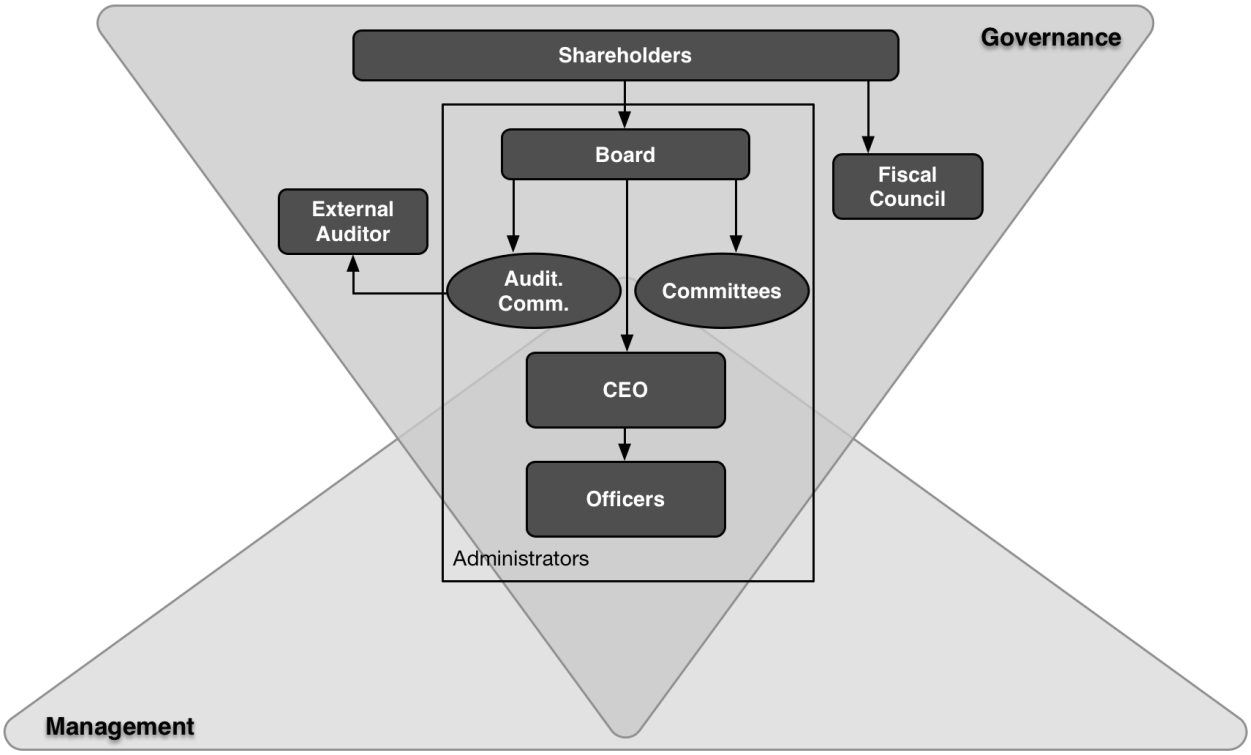
Source: (Page, 2001)

Companies that operate in the coal, iron & steel industry are subject to different regulations. This is mainly due to the high levels of trade unions and the relatively strong work councils in this industry (Page, 2001). However, a deeper analysis of the co-determination characteristics in this segment will be left out as this would ultra pass the boundaries of this paper.

2.3 Corporate Governance in Brazil

Similar to the two-tier board system in Europe, Brazilian Law foresees the establishment of two separate boards. On the one hand the management board (*Diretoria*) and on the other hand the board of directors (*Conselho de Adminsitraçao*). The board with its committees and the management with CEO and its officers are referred to as the company administrators by the IBGC code. Besides these entities, the external auditor and the fiscal council do bear a significant role in the Brazilian corporate governance system. The general meeting is responsible for the appointment of the members of the board of directors. The board of directors is accountable to the shareholders and is responsible to guide and oversee the management board. It also appoints and dismisses the CEO, who has the responsibility to nominate further officers into the management of the organization. Apart from that, the governance structure is characterized by the existence of different committees and a possible fiscal council. The Brazilian corporate governance system cannot directly be assigned to either the Anglo Saxon one-tier model or the European two-tier model. It is much more unites characteristics of both governance models with its own distinctive Brazilian features.

Figure 5: Corporate Governance in Brazil



Source: Code of Best Practices of Corporate Governance (IBGC)

2.3.1 Legal Framework

The legislation in Brazil allows the incorporation of many different company forms. Relevant for this work; it is worth wile mentioning the Brazilian limited liability company (*sociedade empresária limitada, Ltda*) and the Brazilian corporation known as "*Sociedade Anónima*" (SA). The focus of this paper will lie in the "*Sociedade anonima*" which is more relevant for the analysis conducted in this paper. Similar to many other countries the Brazilian limited liability company limits the liability of each shareholder to the total amount of capital invested in the company. Under Brazilian corporate law, it can be formed by either two or more individuals or legal entities. Limited liability companies require little disclosure, thus it is recommended for companies that favor a simple governance structure (Deloitte.dbbrazil.com.br, 2014). Because of this, the main application of this legal form is mainly for wholly owned

companies. The *Ltda* is however restricted to trade shares on the stock exchange. In general three are no capital requirements.

The Brazilian corporation is regulated by the Corporation Act (Law 6404/64 und later expanded by the Law n. 10.303 of October 31, 2001) and also foresees at least two shareholders, who are liable to the stake invested in the company. The updated law of 2001 increased the standards on tag along rights (the same rights granted to all shareholders) and updated the treatment of preferred shares (which was further restricted). Shareholders may be individuals or legal entities. Publically traded corporation are referred to as "*Sociedade por Açoes Aberta*" while on the other hand companies which shares not available to the general public are called "*Sociedade por Açoes Fechadas*". Brazilian Law prescribes a minimum of 10% of the capital as deposit in a bank in form of cash. In general this legal form provides a more sophisticated structure for corporate activities. This is also demonstrated by the requirements that listed company must have a board of directors. The law specifies that listed companies must establish a board of directors (*Conselho de Administração*) and a management board (*Diretoria*).

The shareholders do elect the members of the board of directors. The board of directors is the highest organization organ defined by law. Members are elected for a maximum period of three years and after this re-appointed is permitted. For the removal of directors, the law allows the dismissal at any time by the general shareholders meeting. Furthermore the minimum number of members of the board is three, who all have to be residents of Brazil. Apart from that the law gives the controlling shareholder the right to nominate the half +1 of the members of the board of directors. Guerra (2010) describes that the board of directors is also involved in the definition and approval of strategic decisions.

The management is appointed and dismissed by the board of directors who also defines and describes their duties as officers. The law technically does not prohibit executives to serve on the board of directors. However, it limits the executive representatives to 1/3 of the total number of board members. The law also allows the

CEO to hold the position of the chairman of the board of directors. It is common practice that the CEO completely decides on the appointment of officers on the management board and directs their work (Instituto Brasileiro de Governança Corporativa, 2010).

At the general meeting of the shareholders, all shareholders have the right to attend and to cast their vote. The call for the general meeting has to be published 15 day prior to the actual meeting. During the general meeting shareholders are granted the right to ask company related questions and discuss important corporate matters. Interestingly the Brazilian law gives minority shareholders the possibility to directly appoint a board member representative (OECD, 2009).

2.3.2 Brazilian Stock Markets

Brazilian capital markets were almost non-existing before 1960's and also afterwards played a minor role until the 1990's. The acceleration of the Brazilian industrialization was strongly carried out by President Kubitschek in the 1960's. This resulted in a higher need of financing for Brazilians firms, which as to some satisfied by the former creation of the BNDE – Brazilian Development Bank (*Banco Nacional de Desenvolvimento*). This helped companies to invest and grow. However, Brazilians companies remained in strong family ownership and due to lack of international competition in the 70's and 80's did not invest in effectiveness of their operations. The economic situation in the country at some point became more severe, with long periods of recession, hyperinflation and poor economic policies. Only in the 90's with the beginning of privatization and the opening of the Brazilian market to trade and foreign capital the capital market started to play a more active role in the Brazilian economy. This was also supported by sound economic policy, in form of the *Plano Real,* which finally was able to stabilize inflation in Brazil during the 90s. The following years were characterized by a strong boost of the Brazilian financial markets. Market capitalization increased five times in the time period of 1995 and 2007, while the IBOVESPA the main index increased by about 10 times in the same time period (Zeidan, 2012). Today São Paulo ranks among the major financial

centers of the world and the most important financial market in South America. However, until today the Brazilian corporate governance environment is characterized by a high concentration of voting shares (Carvalhal da Silva, 2005). However several initiatives have been reducing the strong representation of preferential shares in the last years.

The BM&F BOVESPA is the largest stock market in Latin America, and home to the Bovespa index, which includes 50 stocks of major Brazilian corporations.

Interestingly, In 2001 BM&F BOVESPA launched different levels of Corporate Governance requirements and has created 4 tiers in order to differentiate companies according to their corporate governance standards (Black, De Carvalho & Gorga, 2010). In addition BM&F BOVESPA offers *Bovespa Mais*, a listing offered to medium sized companies that gives them flexibility in a less regulated environment. The 3 main higher corporate governance segments are described below:

Level 1 Requirements: These include the maintenance of a free-float of at least 25% of total capital, improved disclosure of quarterly information, disclosure of shareholding agreements and stock options programs and provisions of an annual calendar of corporate events (Silva & Leal, 2005). The requirements still allow that stocks can ben divided into common and preferred shares. Furthermore in order to be listed at Level 1 disputes between shareholders and the company have to be resolved by arbitration ("*Câmara de Arbitragem do Mercado*"). Apart from that, Level 1 requires that in case of delisting from Bovespa, an external independent specialist is appointed to determine the fair value of shares.

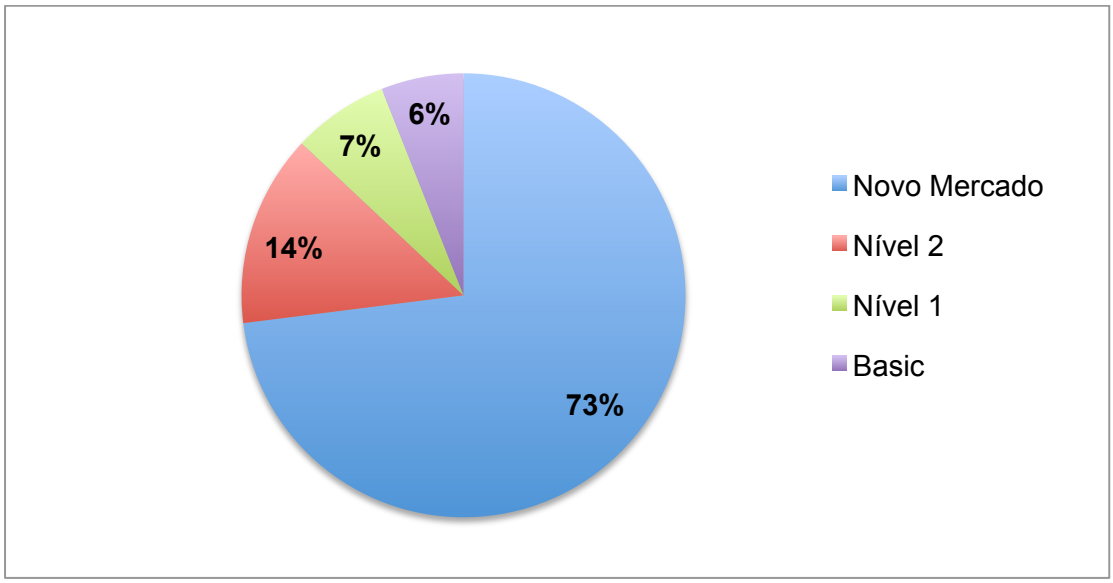
Level 2 Requirements: All of the Level 1 Requirements and in addition to that: single one-year mandate for the entire board of directors, the annual balance sheet available in accordance to US or IAS GAAP, granting all common shareholders the same conditions obtained by the controlling shareholders on the transfer of the firm control and 70% of these conditions to non-voting shares in certain circumstances and adherence to arbitration as the vehicle to resolve corporate conflicts (Silva &

Leal, 2005). Regarding Independence, level 2 demands at least 20% of the members on board of directors to be independent.

Novo Mercado Requirements: All of the Level 1&2 Requirements, in addition to that, the company may not issue non-voting shares (Silva & Leal, 2005). In case of sale of the controlling interest, the buyer will extend the tender offer to all other shareholders, guaranteeing them the same treatment given to the controlling group (Andrade and Rossetti, 2009). The separation between chairman and CEO is also a further requirement in the Novo Mercado.

A statistic of the Bovespa shows that during the time frame of 2004 and 2010 the majority of companies who underwent an Initial public offering started trading their shares under the *Novo Mercado* requirements.

Figure 6: IPO's per Segment



Source: BM&FBOVESPA. (2004-2010)

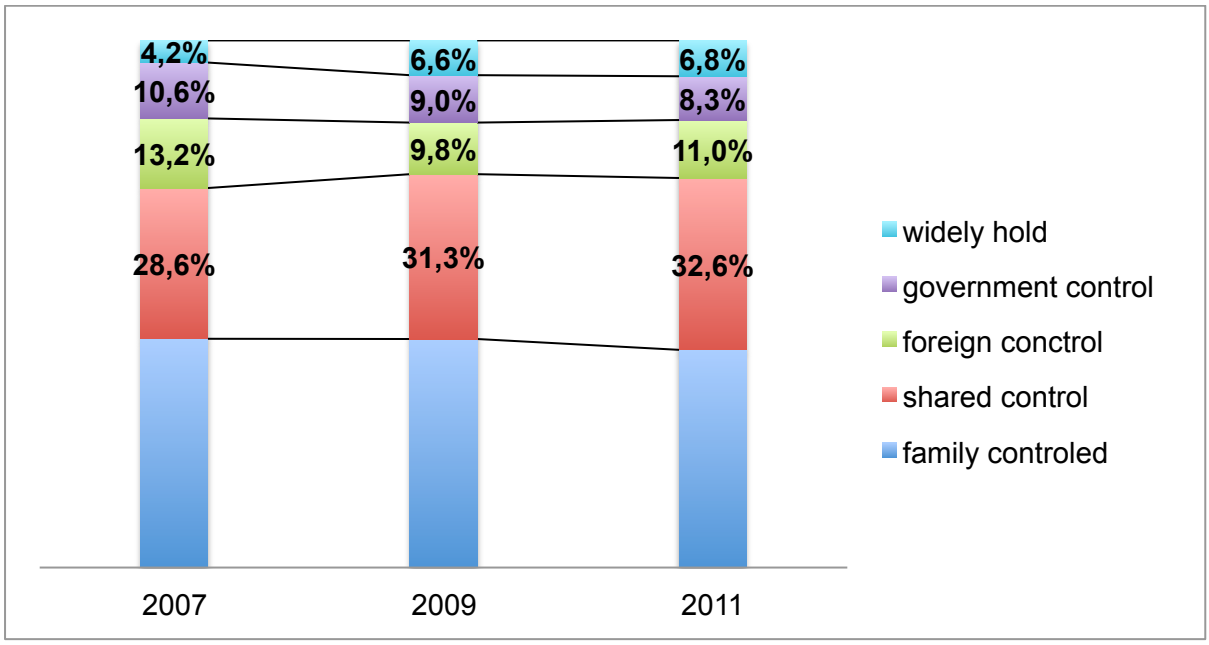
3.3.3 Ownership Structure

In the past Brazilian corporations were characterized by a well-defined controlling shareholder, typically a family (Leal, 2002; Aldrighi, Kalatzis & de Oliveira, 2009). Today's landscape of the Brazilian ownership structure indicates that few

shareholder and wealthy families still control a majority of the companies. The result is that the ownership concentration remained extremely high in Brazil (Berg, Di Benedetta & Ard, 2014). This consequently raises the risk for minority shareholders to experience discouraging actions by controlling owners to prevent them in participating in the governance processes (OECD, 2009).

Brazilian law allows for shareholder to either hold voting shares or/and non-voting shares. This implies that a given shareholder could earn the majority of the voting right while at the same time having a much smaller economic interest (Black, De Carvalho & Sampaio, 2014). The IBGC code as well as the CVM guidelines has been trying to reduce and limit the existence of the dual class system of shares in Brazil.

Figure 7: Brazilian companies breakdown by type of controlling shareholder



Source: (Da Silveira, 2012)

In this study done by (Da Silveira, 2012), the author shows that Brazilian listed companies still remain to a large proportion in the hands of families. What surprises, are the relatively low amounts of companies that are controlled by foreign entities.

The representation of governments as controlling shareholder has been declining constantly since 2007.

Fehre (2011) already recognized that concentration of ownership is higher for countries with less developed capital markets. Similar to Germany the market capitalization of listed companies as % of GDP remained low after peak in 2007 (Data.worldbank.org, 2014). But compared to the average ratio in Latin America, Brazil shows a more developed scenario.

2.3.4 Code of Best Practice of Corporate Governance

Public listed companies are subject to CVM regulations. The IBGC Code of Best Practices serves as body to promote best corporate governance practices, in particular among Brazilians public listed companies.

The CVM is referred to as the securities and exchange commission of Brazil (*Commissão de Valores Mobiliarios*). Their principal responsibilities lies in overseeing the market, market intermediaries and listed corporations. The CVM operates by issuing instruction, legal opinions and circular notes (OECD, 2012). In addition the CVM can enforce its power trough both warnings and fines. Moreover, the CVM has published a set of guidelines (*Cartihla de Recomendaçoes sobre Governanca Corportiva*) on corporate governance practices.

The IBGC (*Instituto Brasileiro de Governança Brasileiro*) was founded in the 1990's during a period when Brazil was experiencing a wave of privatization. Furthermore corporate governance standards became increasingly important to gain the confidence of foreign investors. The IBGC should serve as Non Profit Organization promoting good governance. Its principal aim is to contribute to good governance practices among Brazilian listed corporations.

The code should serve as instrument for companies to implement good corporate governance practices. The first edition was published in 1999 and later was revised and expanded. The latest edition is the fourth edition published in 2010. Similar to

the German corporate governance the code of best practice of corporate governance is also divided into six sections:

1. Ownership
2. Board of Directors
3. Management
4. Independent Auditing
5. Fiscal Council
6. Conduct and Conflict of Interest

In the first chapter the IBGC clearly support the “one share = one vote” concept, avoiding the existing of preferred shares and gives all shareholders the right to vote during the general meeting. It also highlights the importance of giving all shareholders equal treatment not only regarding voting rights but also in regards to accessibility of information and in the case of transfer of control (Tag along rights). Moreover, this chapter also includes some explanation on how the general meeting of shareholders should be constructed and what should be subject of the general Meeting. This section also highlights the responsibilities and powers of the general meeting. Moreover, it includes a recommendation on the structure of the agenda of the general meeting. The IBGC furthermore recommends the establishment of a family council for organization with a family as controlling shareholder.

The IBGC code explicitly states that the board of director “is the link between shareholders and management”, thus should “guide and oversee management and its relationship with other stakeholders”. Among responsibilities of the board, there are many different responsibilities including decisions on: hiring/dismissing the CEO and other officers, strategy, capital structure, risk management, mergers & acquisitions just to list a few. The code is also very clear to draw the line between management board and board of directors. Hence, the code states that the board of directors should not interfere in operating matters of the organization and leave this to the management. Regarding the composition of the board, the code strongly emphasizes the importance that the board remains bound to none of the

shareholders in particular. The board rather has its duties to the organization as a whole and consequently to all shareholders. A further statement is concerned with the necessary skills of the members of the board, highlighting the board should collectively embody all skills needed. According to the code, the term of board member should not exceed two years. The code also reminds that members should have the necessary time to contribute significantly to the work of the board. The code also emphasizes that the CEO should not be an active member of the board and especially not hold the position as chairman. However, participation as “guest” is recommended. While the code is not making a clear recommendation on how many independent directors should be represented on the board, it clearly stresses the appropriate representation of independent directors depending on the “maturity of the organization”. The code also argues that an existence of an advisory board improves good corporate governance practices. Activities of the advisory board should be well defined and it can be set up as a temporary body. The code sees the formation of committees as essential part of the corporate governance structure. Especially the formation of an audit committee and a human resource committee are recommended. A particularity of the IBGC code is the establishment of an internal audit, which may be outsourced and has the responsibility to enhance the processes within the governance structure of an organization. The board should meet regularly in order to ensure the effectiveness of the board. However the board should not meet more than once a month to avoid inference with management responsibilities.

The CEO, who is hired by the board of the directors, holds the full responsibility of organizing and coordinating the management board. This means that it is within the responsibility of the CEO to nominate other officers and propose their compensation for approval of the board of directors. The code also mentions the importance of providing all kind of stakeholder with the appropriate information in timely manner also in form of the respective reports. The Code suggests that the board of directors on annual basis evaluates the CEO. The CEO in a second step should have the obligation to evaluate all officers on the management board. According to the code,

compensation should be “linked to results, with short and long term goals, clearly and objectively associated to the creation of economic value for the organization”.

The independent auditor is hired to determine if the financial statements have been reported adequately to reflect the situation of the organization. The auditor is hired by either directly by the board of director or the audit committee, and should not provide consulting projects to the organization. The code emphasizes the importance of a completely independent external auditor.

The fifth section comments on the establishment of a fiscal board. The fiscal council is described and explained in a later chapter as Brazilian specialty in this paper.

Lastly, the sixth section of the code concerns itself with potential conflicts of interest and argues that it lies in the duty of any administrator to be aware of potential area of conflicts and declare those. This also would include the use of insider information for the benefits of third parties. Furthermore, the IBGC code recommends that management prepares a code of conduct stating the principles and policies defined by the board of directors.

Major points of the IBGC code:

→ It is remarkable that both the IBGC Code and the guidelines of the CVM focus much of their attention on the protection of minority shareholders and shareholders with no voting rights.

→ It is expected that the board of directors are committed directly in matters such as strategy and risk management

→ The importance of committees is highlighted, as it serves as body of expertise to the board of directors.

→ The CEO serves as central person in the coordination of the executives and officers.

2.3.5 Brazilian Characteristics

The fiscal council is one of most exceptional characteristics Brazilians Corporate Governance characteristics. In principal, its existence is not mandatory but can called out by a decision of shareholder holding just 5% of common shares or 10% of voting right shares. The fiscal council can hold between three and five members. The fiscal council is not part of the administration of the company. It is much more a independent supervisory & inspection organ that directly reports to the shareholders. Thus it acts completely independent from the board of directors and the management board. It can be set up temporarily or permanent depending on the purpose of the fiscal board.

The fiscal board should inspect the administration of the organization with focus on compliance. Apart from that it should also serve as opinion maker on the annual report or on any propels brought up by the administration bodies. The code recommends that the majority of the fiscal council should be made of non-controlling shareholders.

3. Analysis

3.1 Methodology

The fact that the implementation of corporate governance is not measurable in numbers and that it is somehow very intangible made the comparison of the implementation of corporate governance standards a challenge.

This study compares the implementation of corporate governance on the practical example of two companies. Both companies operate in the same industry, are listed in their home country major stock exchange and are known for their high corporate governance standards. The analysis screens the development of corporate governance standards during a time frame of 5 years (2009-2013).

As a result of the corporate governance literature I decided to compare 3 different parameters and analyze some variables for each parameter:

Composition:

- Size and Independence of board of directors
- Size and Responsibilities of the management board

Procedures:

- Number of meetings hold per year (supervisory board)
- Number of committees and their involvement in corporate matters

Compliance with the local Code:

- Deviation from Recommendations

Composition

The fact that a large part of the literature (Daily and Dalton 1992; Peng, 2004; Petra, 2005; Barnhart, Marr & Rosenstein 1994; Rosenstein & Wyatt, 1990; Schellenger 1989) associates the reduction of agency costs with the independence of the board of directors makes the measurement of this variable as a very relevant for this comparison. The recent development in the US with the introduction of the Sarbanes

Oxely Act of 2002, which also highlighted the importance of independence throughout the board of directors highlights the importance of independence at board level. In Brazil both the CVM and IBGC strongly promote the independence of the board of directors. Size of the board of directors has been regarded as a further significant variable in the literature, giving insights about the effectiveness of the board. Jungmann (2007) found that the smaller the number of board members the more likely it is that members will contribute actively to the board. Furthermore (Bermig & Frick, 2011) recognized that the size of the board could have different impacts on firm performance.

The comparison of the size and the responsibilities of the management boards will not only show how power is distributed among the governance systems, but also what kind of responsibilities each organ holds in each system. This will somehow highlight the governance structure and show the characteristics of each system in a practical environment.

Procedures

It will highlight how board procedures do differentiate from each other; especially the number of meetings and the involvement of committees in company matters will provide valuable insights of each system. However, the quality of corporate of governance cannot be connected with the number of board of directors meetings per year. However it shows the involvement of the board and gives some insights on how the board works together with the management board. Interestingly, is to see what kind of corporate topics are covered by the committees. Recent development in both country codes has emphasized the importance of committees in the corporate governance structure of enterprises.

Deviation from the Code

Lastly both countries have corporate governance codes published by an official organ. The compliance to the code will be described and deviations to the local code will be explained for both companies. This should also demonstrate how much of the code is implemented into the practical environment the companies operate. Of

course as both codes have different recommendation and a different practical significance, it only gives some insights on how much of the best practices have already have been implemented. Furthermore, due to large complexity, we only analyzed the deviation from the 2013 annual report with the most updated code at each country.

In the end this should give insight on how the practical implementation of corporate governance standards differentiates itself in two completely different environments.

3.2 Beiersdorf

Beiersdorf, headquartered in Hamburg in the northern part of Germany is a global leader in the consumer goods industry. It focuses its operations in two business segments; consumer business segment with brands in the skin and body market care. And secondly, in the tesa business segment which manufactures self-adhesive products. The company has a tradition of 130 years and under its famous brands it has names such as NIVEA, Elastoplast, Eucerin, Labello and La Prairie. Today it employs some 16.000 persons around the world. In 2013 it accounted sales of €6,1 billion and since 2009 sales have increased 1,3% per year. At the same time it shows a profitability ratio of around 13% for 2013 (EBIT/Sales).

Figure 8: Beiersdorf Shareholder Structure

Source: Annual Reports of Beiersdorf AG of the years 2009-2013

The last 5 years have not shown any significant movement in the ownership structure of Beiersdorf AG. What stands out is the participation of the maxinginvest group, a family owned company, which also holds 100% in the prominent Tchibo GmbH. Some members of the family also make part of the supervisory board. As discussed earlier, this shows that Beiersdorf controlling shareholder is a family, which still is a common characteristic in some of the major German corporations.

3.3. Development of Corporate Governance at Beiersdorf

3.3.1 Composition

Table 2: Number of Executive Board Members at Beiersdorf

Year	Number of Executives
2013	4
2012	4
2011	5
2010	6
2009	6

Source: Annual Reports of Beiersdorf AG of the years 2009-2013

The size of the executive board has been decreasing since 2009 from 6 members to 4 members in 2013.

Responsibilities of the Executive Board

The duties of the executive board are divided by regions and functions. It is clear that the executive board develops the strategy and then in a second step discusses it with the supervisory board. It has full the responsibility for the implementation of the agreed strategy. Risk management and risk control is a further essential part of the work of the executive board. Apart from that, the executive board prepares the annual/quarterly reports as well as the consolidated financial statements when they are due. It has been common practice to grant executives stock option as part of their remuneration.

Supervisory Board

Table 3: Number of Supervisory Board Members at Beiersdorf

Year	Number of Members
2013	12 (6 employee representatives)
2012	12 (6 employee representatives)
2011	12 (6 employee representatives)
2010	12 (6 employee representatives)
2009	12 (6 employee representatives)

Source: Annual Reports of the Beiersdorf AG of the years (2009-2013)

The number of supervisory board members at Beiersdorf remained completely stable throughout the period of analyses.

Table 4: Independent Members of the Supervisory Board

Year	Independent Supervisory directors (Name)
2013	2 (Eberhartinger, Martel)
2012	2 (Eberhartinger, Perraudin)
2011	3 (Eberhartinger, Dreyfuss, Perraudin)
2010	1 (Eberhartinger)
2009	0

Source: Annual Reports of the Beiersdorf AG of the years (2009-2013)

In order to analyze the number of independent members of the supervisory board, the annual reports of Beiersdorf were screened. From 2009-2011, there was no explicit statement on the number of independent directors. However, interpreting profession and membership on other boards helped to identify independent members. The annual reports of the years 2009-2013 provide following conclusion:

3.3.2 Procedures of the Supervisory Board

Table 5: Number of Supervisory Board Meetings

Year	Number of Meetings
2013	7
2012	8
2011	8
2010	6
2009	5

Source: Annual Reports of the Beiersdorf AG of the years (2009-2013)

The number of meeting of supervisory board at Beiersdorf does not follow a certain pattern. The total number of meetings also includes extra ordinary meetings, which have been called in order to resolve urgent issues.

Table 6: Committees of the Supervisory Board

Year	Committees
2013	Presiding, Audit, Finance, Nomination, Mediation
2012	Presiding, Audit, Finance, Nomination, Mediation
2011	Executive, Audit, Finance, Nomination, Mediation
2010	Executive, Audit & Finance, Nomination, Mediation
2009	Executive, Audit & Finance, Nomination, Mediation

Source: Annual Reports of the Beiersdorf AG of the years (2009-2013)

Throughout the five-year period the change in committees was only subject to minor adjustments. At first, the separation between audit & finance committee into two

separate committees has been done in 2011. Secondly, the change from executive committee into a presiding committee was accomplished in 2012. While the separation of the audit and finance committee came with the separation of different activities the presiding committee took over the majority of the activities of the executive committee. A short explanation of the main activities is provided in the next part.

Presiding Committee: discusses recent business developments and strategy issues. Also takes care of defining the composition of the executive board, remuneration of the executives and the supervisory board.

Audit Committee: examination of the annual and quarterly financial reports. Also, appoints the auditor and verifies its independence.

Finance Committee: They cover topics such as compliance, transfer prices, taxes and financing and investment strategy

Nomination Committee: This body is responsible for the nomination of supervisory board members.

Mediation Committee: Co-determination feature, which makes proposals on the election and nomination of the executive board.

Executive Committee: was responsible for the preparation of supervisory board meetings. But also tackles strategic issues as well as definition of the composition and remuneration of the

3.2.4 Deviation from the Code

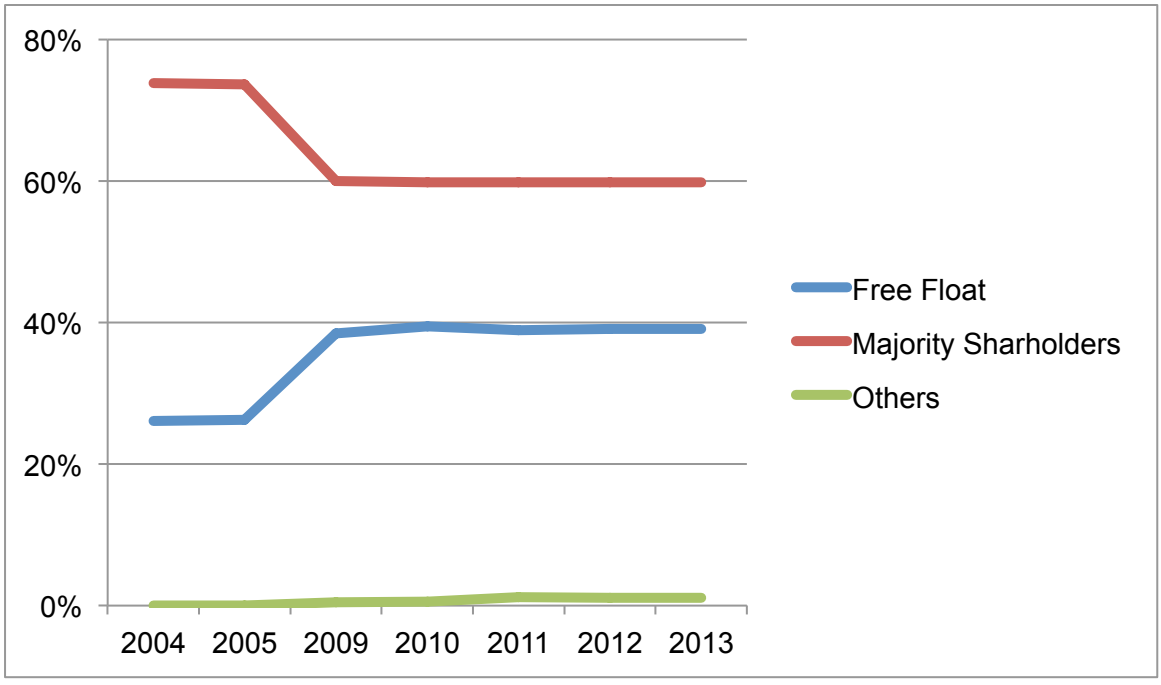
As German law demands Beiersdorf has been publishing a declaration of compliance to the German Corporate Governance Code. In 2009, Beiersdorf followed all recommendation of the German corporate governance code with the exception of one particular recommendation regarding the remuneration of the executive board. In 2010, the company did not comply to this recommendation yet, however commented that remuneration of the executive board has been revised.

Technically Beiersdorf was able to fully comply to the code in 2011, with the resignation in 2012 of the former CEO. At the general meeting of 2012 all recommendations of the German corporate code have been complied. However this was changed with the updated version of the German corporate governance code, which foresees a cap for the remuneration of executives, for both, the variable part and the fixed part. Beiersdorf grants its executives an enterprise value component, a voluntary personal investment vehicle. The supervisory comments that a restriction of this vehicle would not be appropriate, as it participates both negatively and positively to the change in enterprise value.

3.4 Natura

Natura is a Brazilian company, which mainly operates, in the personal hygiene, perfumery and cosmetics sector. With about 7.000 employees it is also the second largest Brazilian company in this industry. Natura decided to launch an initial public offering in 2004 and started to trade shares at the Novo Mercado of BM&F Bovespa. This step also marked the separation of ownership and management. In 2003 for example the board of directors was compromised of 5 members of them three were internal directors and only two were external and independent. Natura is known for its strong promotion of eco-friendly products and its focus on sustainability. Total revenues reached $R7,0 billion in 2013 (€2,35 billion). In the last 5 years Natura could grow its sales by 13% per year. Its profitability measured by (EBIT/Sales) stood at around 16%. With a strong product portfolio and well-implemented distribution system they have been able show above average growth in the last years.

Figure 9: Natura's Shareholder Structure



Source: Annual Reports of Natura of the years (2009-2013)

In the financial year of 2013 the biggest majority shareholders where the founding partners Antonio Luiz da Cunha Seabra, Guillherme Peirrão Leal and Pedro Luiz Barreiros Passos. Natura underwent an initial public offering in the São Paulo stock exchange in 2004. At that time the founding partners dedicated themselves to the highest standard of corporate governance in Brazil and therefore were listed in the *Novo Mercado*. As a result the stake of the majority shareholders decreased while at the same time the proportion of free float increased to about 40%.

3.5 Development of Corporate Governance at Natura

3.5.1 Composition

Table 7: Number of members on the Executive Board

Year	Number of Executives
2013	10
2012	6
2011	5
2010	6
2009	7

Source: Annual Reports of Natura of the years (2009-2013)

Responsibilities of the executive board

The Executive board is referred to as the Executive Committee (COMEX). They are headed by the CEO and have different positions taking care of various functional activities. The executive committee is responsible for the development of strategic projects and the strategic planning and implementation. At the same time they conduct the overall business management of the company. It should also be noted that executives hold shares in form of stock option in the company.

Board of Directors

Table 8: Number of members of the board of directors

Year	Number of Members
2013	9 (3 Independent)
2012	9 (3 Independent)
2011	7 (2 Independent)
2010	6 (3 Independent)
2009	7 (2 Independent)

Source: Annual Reports of Natura of the years (2009-2013)

In 2013 none of the members of the board of directors had an executive position within Natura. The number of Independent directors has increased as well as the total number of board members.

3.5.2 Board Procedures

Table 9: Number of board of director meetings

Year	Number of Meetings
2013	7
2012	6
2011	6
2010	6
2009	N.A.

Source: Annual Reports of Natura of the years (2009-2013)

The number of meeting of the board of directors did not change significantly over time. Unfortunately, in the annual report of 2009 there we no comments on the number of meetings held by the board of directors.

Table 10: Committees of the board of directors

Year	Committees
2013	Strategy, Corporate Governance, People and Organizational Development, Audit/Risk Management & Finance
2012	Strategy, Corporate Governance, People and Organizational Development, Audit/Risk Management & Finance
2011	Strategy, Corporate Governance, People and Organizational Development, Audit/Risk Management & Finance
2010	Strategy, Corporate Governance, People and Organizational Development, Audit/Risk Management & Finance
2009	Strategy, Corporate Governance, Organization and People, Audit/Risk Management & Finance, Sustainability, Process, Brand, Quality of Relationships

Source: Annual Reports of Natura of the years (2009-2013)

The committees at Natura are seen as supporting organs to the executives in their respective area. Therefore they also consist to some extend of internal directors. The CEO for example is representative in the strategy committee.

The committees of 2013 has explained the activities of the committees accordingly:

Strategy: Apart from building an international expansion plan it also oversees at monitors' current strategic projects.

Corporate Governance: ensures the adjustments and improvements to the company corporate governance system in order to reach international best practices.

Audit/Risk management and Finance: ensures the correct operation of the internal and external auditors. The internal auditor reports to this committee. They cover topics such as risk management, financial policies and processes. Two external consultants experts in the field of accounting support this committee.

People and Organizational Development: Not only takes care of the executive compensation but also other fundamental decisions related to Human Resources.

One specialty about the formation of the committee's at Natura is the fact that the have included representatives of the Management Board in some of the committees.

3.5.3. Compliance to the Code

The recommendations and comments of the IBGC are very extensive. It was impossible to verify every aspect mentioned in the code of the IBGC. However major points that Natura did not comply were highlighted:

- Educational programs for directors of the board.

No statement in the annual report referring to any educational programs for member of the supervisory board. The code explicitly states; " It is essential that directors seek to constantly improve their skills."

- Formal assessment of the performance of the board on yearly basis

The board did not undergo a self-assessment in the year of 2013. Natura has justified this due to changes made in the board structure.

- IBGC correlates the existence of an advisory board with good practices of corporate governance.

There are no comments about the existence of an advisory board.

- The audit committee and human resource committee should be made of independent directors

The people and organization committee does not consist exclusively out of independent directors. The identification of independent directors at the audit, risk management and finance committee is not possible as there are no references which board members are independent or not. However given the size of this committee it seems extremely unlikely that it solely consists of independent members.

4. Results

Composition

The size of the Management Board has been significantly smaller at Beiersdorf then at Natura. The executive board at Beiersdorf has been varying between 4 and 6 members and in 2013 is represented by 4 members. The variation at the executive board of Natura has been by far greater, fluctuating between 5 and 10 members. At Natura, the maximum number of members of executives has been reached in 2013. This shows a significant difference in the overall size of management. In addition, one can observe that the movement at Beiersdorf has been towards a smaller executive board while the opposite has been true at Natura.

A great overlap in the definition of the responsibilities of the management board can be detected. The fact that Natura has established a strategy committee, already shows that the board of directors is not only a discussion partner for major strategic decisions but also can to a certain extend give impulse in the direction of the firm. The inclusion of executives in the committees shows the strong involvement of committees in the proper management of the firm. In contrast to this development, the governance report published by Beiersdorf states that the strategy is discussed with the supervisory board however developed and implemented by the executive board. This is also in line with the research done, which highlights that in the Brazilian corporate governance structure, the board of directors has much more power to actually influence strategy and other operational decision-making. Ultimately however, it can be concluded that the range of responsibility of both executive boards in both countries cover very similar aspects of corporate matters.

There is no doubt that the size of supervisory board at Beiersdorf is bigger than that of Natura. However if one disregards the employee representatives within the supervisory board at Beiersdorf it constantly consisted of 6 members and therefore was smaller than the board of directors of Natura. What is also notable is the inconsistency of the size of the board of directors at Natura. While the size of the

supervisory board at Beiersdorf remained completely stable throughout the examining period, the board of directors of Natura fluctuated between 6 and 9 numbers.

Regarding the Independence of the two boards, it is worthwhile mentioning that both companies have been increasing the proportion if independent directors in their board throughout the examined period. Beiersdorf, which in 2009 had no independent representative in the supervisory board in 2013 already, included 2 independent members in the board. This consequently resulted in a proportion of 33% of the shareholder representatives. By contrast to that development, Natura already was holding one independent director in its board in 2009. By 2013, Natura increased the number to 3 members out of 12. This also resulted in a representation of 33% by independent directors out of the total board members.

Procedures

Regarding the number of meetings one can observe a very similar picture at both companies. In general, throughout the analyzed period Natura gathered its board of directors on average 6,25 times per year. On the other hand, during the 5-year period the supervisory board of Beiersdorf met significantly more often with an average of 6,8 meetings per year. This somehow indicates that the focus of governance structure in Natura lies in the committee's work while in Germany though the supervisory board only has supervising duties, it meets more often in order to discuss corporate matters. Another simple explanation for the meeting frequency might be connected to the size of the supervisory board at Beiersdorf. While smaller board work more effectively, larger board do have to meet more often in order to meet the same standards in efficiency.

The different application of committees at both companies also becomes vey obvious. First of all, in 2009 Natura had a total of 8 committees working for the board of directors. In the same year Beiersdorf had only 4 committees. Since 2009 Natura drastically reduced the numbers of committees, until it reached 4 as well in 2013. Content wise, the committees at both companies cover almost the same topics. In

contrast to Beiersdorf, Natura has established a corporate governance committee that promotes best corporate governance practices. The fact that insider executives are represented to some extend at Natura committee's highlights another difference and suggests that Natura board committee's are much more involved in the management matters than Beiersdorf's committees are.

Deviation from the codes

Beiersdorf has only been able to totally comply with the German governance code in the financial year of 2012. The administration of the company has provided understandable arguments why in 2013 the code was not 100% complied again. But in general, with one exception all recommendations of the code were implemented in the corporate governance structure of Beiersdorf. Natura has complied with a great number of recommendations of the IBGC code. Several issues however, either have been left uncommented or have not been complied with. In total, Natura has shown great willingness to implement all recommendation provided by the IBGC code, however it one can conclude that Beiersdorf has been able to comply more to its local corporate governance code than Natura.

5. Conclusion

The purpose of this paper was to examine the difference of two corporate governance systems (Germany and Brazil) and their implementation in practice. This was done by comparing three parameters, in two different companies, each representing one country.

With no surprise, the comparison shows inconclusive results. Both companies have been following the international trend and the pressure towards a more independent board. It was remarkable to observe that both companies share a similar ownership structure and recently have shown the same proportion of independent representatives in their respective board of directors. Regarding the size of management board and board of directors (supervisory boards) they do differentiate significantly. Of course this has been influenced to some extend by the local legal environment (co-determination in Germany), but also gives insights on how the responsibilities are divided in both governance systems. Here we can conclude that the board of directors of Natura in Brazil is more involved in the actual management than its counter part at Beiersdorf in Germany.

Regarding the number of meetings one could observe similar picture at both companies. Both board of directors meet approximately every two months. This frequency, to some extent has been practice in many developed countries around the world. The importance of committees and their involvement has been emphasized by both codes. It is notable that both companies do cover for the most part the same topics. However it can be concluded that, Natura committees are much more used as an organ to challenge and at the same time support executives while at Beiersdorf committees are established to help and support exclusively the supervisory board.

Both companies in both countries have been following the local recommendations of the local code to a large extent. The fact that Beiersdorf was able to meet all recommendation of the German code in 2012 and only had one deviation in 2013

gives reason to believe that Beiersdorf has been able to implement a larger amount of corporate governance best practices than Natura.

A possible explanation of the differences in the implementation of corporate governance practices in both companies comes on the one hand with the strict separation between the responsibilities of management board and supervisory board given by the German law. The clear separation of responsibilities of German supervisory board from the management board might explain why Beiersdorf supervisory is less involved in management topics of the company. On the other hand the local standings of the codes have different impacts for companies. The larger amount of deviations from the code at Natura might be explained by the standing of the local Brazilian code in its stock exchange. While in Germany, listed companies are obliged to comment on deviations from the code (soft law character), in Brazil companies are not required to refer to the code all. The Brazilian code serves as pure guidance vehicle and its compliance relies only on the willingness of any given company.

It is most certainly not possible to conclude that one corporate governance system is actually superior to the other one. But of course, both corporate governance systems can to some extend learn something from each other. While in Brazil, corporate governance may benefit from the reduction of preferred shares it may also profit from more involvement by minority shareholders and employees (like in Germany). On the other side, the fiscal council is an excellent vehicle, which clearly has some similarities and some parallels to the German supervisory board and should be promoted by regulatory organs in Brazil. Furthermore the mandatory requirement for listed companies to comment on the compliance to the local code in Germany might also pushes the implementation of best practices in Brazil.

6. Limitations and future research

There is no doubt that a comparison of two different companies operating in completely different environment somehow comes with “natural” limitations. First of all, the business environment in which Beiersdorf operates most probably allows it implement best corporate governance practices more easily.

Second, of course it is difficult to correctly measure the implementation of best practices. The fact that procedures are very different in various corporate governance systems does not gives insight about the quality of corporate governance nor about the level of best practices implemented.

Lastly, there has been disagreement in the literature of corporate governance to what extend corporate governance features, such as independence and procedures really have a significant impact on the performance of a corporation. For example, while a large part of the literature argues in favor of board independence, Westphal (2013) highlights that board interlocking might be associated with social learning and imitation. In addition to that Fich & Shivdasanti (2006) indicate that outside directors have restricted time availability and therefore contribute less. Schalka (2013) shows in her study that a high percentage of outside directors on the board and ownership of institutional investors might even lead to worse performance. Braga-Alves & Shastri (2011) in their study argue that good practices of corporate governance do not necessarily lead to better operating performance.

Corporate Governance is furthermore not limited to the visible player in the system. It is also clear that several different invisible players such as trade unions, governments, Lobby groups and so on, have a very influential role in any corporate board & organ. However it would ultra pass the scope of this work to analyse and understand the influence on firms of those invisible players. But there is no doubt that future research and attention should also be devoted to those aspects of corporate governance.

In further research it would make sense to compare the proportion of insider equity of the total remuneration of executives and directors. Nyberg, Fulmer, Gerhart & Carpenter (2010) argue that equity ownership is an efficient approach in aligning shareholder interest with those of executives. A study measuring the practical impact of equity ownership on the corporate governance system would most certainly make sense. Another aspect that may be interesting to analyze, is the development of diversity on the top level of corporations. Recently, European legislators have been strongly pushing diversity and independence in corporate boards. However, the complete impact of those developments is unclear and should be further investigated in future research.

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