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One Decade of Evolution of Corporate Governance Practices in Brazil

(Uma Década de Evolução das Práticas de Governança Corporativa no Brasil)

Ricardo Pereira Câmara Leal*¹

André L. Carvalho**

Ana Paula Iervolino***

Abstract

This study presents the evolution of certain corporate governance practices of listed Brazilian companies from 2004 to 2013 gathered in an index (CGI). Results indicate that the overall quality of these practices improved, notably after the creation of voluntary membership exchange trading lists that require better corporate governance and disclosure practices. The average CGI score of 5.8 (out of 10.0) in 2013 may be considered low and points to the need for further improvement. Moreover, firms score very low in the ethics and conflicts of interest aspects of the CGI, when compared to its disclosure, board composition and functioning, and shareholders rights components. The very small number of firms that ban loans to related parties and that facilitate participation in the shareholder meetings is a concern. The decrease in the use of control enhancement mechanisms, such as non-voting shares and indirect control structures, was a remarkable achievement. Even so, shareholder agreements are increasingly used as instruments to interfere with director independence and leverage the controlling bloc power.

Keywords: corporate governance index; conflicts of interest; board of directors; disclosure; shareholder rights; Brazil.

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* The Coppead Graduate School of Business at the Federal University of Rio de Janeiro (UFRJ), Rio de Janeiro, RJ, Brazil. E-mail: ricardoleal@coppead.ufrj.br

** IAG, Pontifical Catholic University of Rio de Janeiro (PUC-Rio), Rio de Janeiro, RJ, Brazil. E-mail: andreacarvalho@iag.puc-rio.br

*** University of Antwerp, Antwerp, Belgium. E-mail: iervolinoana@gmail.com

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JEL Classification: G32, G34

Resumo

Este estudo apresenta a evolução de certas práticas de governança corporativa de empresas brasileiras negociadas em bolsa entre 2004 e 2013 que compõem um índice (CGI). Os resultados indicam que a qualidade dessas práticas melhorou, especialmente após a criação dos níveis diferenciados de negociação de adesão voluntária na bolsa, que exigem práticas melhores de governança corporativa e transparência. O CGI médio de 5,8 (em um total de 10) em 2013 pode ser considerado baixo e sugere que pode haver mais espaço para melhoria. Além disso, as empresas pontuam muito baixo nos aspectos de ética e conflitos de interesse do CGI, quando comparadas com os componentes sobre transparência, composição e funcionamento do conselho e direitos dos acionistas. O número muito pequeno de empresas que proíbem empréstimos a partes relacionadas e que facilitam a participação nas assembleias de acionistas é uma preocupação. A diminuição de mecanismos de aumento do controle, como as ações sem direito de voto e estruturas indiretas de controle, foi um avanço notável. Mesmo assim, os acordos de acionistas são cada vez mais empregados como instrumentos que interferem com a independência dos conselheiros e aumentam o poder do bloco controlador.

Palavras-chaves: índice de governança corporativa; conflitos de interesse; conselho de administração; transparência; direitos dos acionistas; Brasil.

1. Introduction

Corporate governance encompasses many aspects, such as ownership and control structures (Shleifer and Vishny, 1997; La Porta *et al.*, 1998, 1999; Claessens *et al.*, 2000, 2002), takeover defenses (Schwert, 2000; Field and Karpoff, 2002), executive compensation (Brick *et al.*, 2006; Adams and Ferreira, 2008), and board of directors size and composition (Hermalin and Weisbach, 1991; Yermack, 1996; Eisenberg, Sundgren, and Wells, 1998). These governance mechanisms can be adopted simultaneously or alternatively. Many international studies used broad firm-level indices based on these aspects to gauge the quality of corporate governance practices (Klapper and Love, 2004; Drobetz, Schillhofer, and Zimmermann, 2004; Bhagat and Bolton, 2008; Black, Carvalho, and Gorga, 2012).

There have been many initiatives to improve corporate governance practices and investor protection in Brazil. The “New Law of Corporations”, Law 10,303 of 31 October 2001, and the Brazilian



Securities Commission (*Comissão de Valores Mobiliários*, CVM) Instruction 480 of 7 December 2009, which introduced the Reference Form (*Formulário de Referência* or FR) with many additional and more detailed disclosure requirements, are two very important recent pieces of regulation. The Code of Best Practices produced by the Brazilian Institute of Corporate Governance (IBGC) and the “Corporate Governance Recommendations” advanced by CVM are two compilations of recommended best practices, even so, there is no “comply or explain” requirement in Brazil. The Securities, Commodities and Futures Exchange of Brazil (BM&FBovespa) introduced three premium segments in 2000. Companies join them voluntarily and commit to comply with their corporate governance and disclosure listing requirements. The three premium lists are called Level 1, Level 2, and *Novo Mercado*, with increasingly more demanding corporate governance and disclosure stipulations. The general non-premium segment of the exchange is called the traditional market. The exchange designed the BovespaMais segment for small and midsize companies and allows for small-size fundraising transactions and gradual capital market access. The number of companies listed in the segment is very small, in many years, just one company. Leal (2011) provides more details about these initiatives and Carvalho and Pennacchi (2011) offer more on the premium listing segments.

The purpose of this article is to analyze the evolution of a broad corporate governance index (CGI) that provides a comprehensive description of firm-level corporate governance practices of Brazilian firms from 2004 to 2013. The index is a score derived from publicly available company information used to answer questions in a questionnaire. The questionnaire includes questions on the aforementioned corporate governance aspects. Leal and Carvalhal (2005, 2007) designed the first versions of the CGI questionnaire with 15 and 24 questions, respectively, in a project sponsored by the Inter-American Development Bank (IADB) in 2003. After 2004, the IBGC has been sponsoring the annual collection of the CGI to promote better corporate governance practices in Brazil. The IBGC supported questionnaire introduced in 2004 has 20 questions. We have used this later version of the questionnaire to compute the CGI score in Carvalhal and Subrahmanyam (2007), Leal *et al.* (2009, 2010), Carvalhal and Nobili (2011), Carvalhal (2012), and Barros *et al.* (2015).

Our contribution in this article is to offer a portrait and discussion about the evolution of Brazilian corporate governance practices captured in the 2004 version of the CGI in listed companies. We take stock of an

important decade for Brazilian corporate governance practices, beginning with the listing of the first IPO in *Novo Mercado* in 2004, through the IPO wave years of 2004-2007, and the international crises period in the remainder of the sample. We point out what improved and what still requires more corporate effort. As a by-product, the article offers many citations of the recent Brazilian literature on the topic.

This article is closely related to Black, Carvalho, and Sampaio (2014) who present the evolution of their questionnaire based on a survey for the years 2004, 2006, and 2009. Their results stem from a more limited sample in terms of the number of firms and years surveyed because they rely on company responses. They do not obtain all of their answers from publicly available information. On the other hand, they are able to offer more details about some aspects of Brazilian corporate governance practices than we do. Silveira, Barros e Famá (2006) and Silveira and Barros (2008) present results for 2002 from a similar score developed independently by professor Alexandre di Miceli da Silveira around the same time. Leal and Carvalho-da-Silva (2005, 2007) provide details on a 15-question questionnaire for the 1998-2002 period and for a 24-question questionnaire for 1998, 2000, and 2002, which were earlier versions of the CGI.

Lima and Sanvicente (2013) also computed a similar score for their analysis of the impact of corporate governance practices on the cost of capital of Brazilian listed companies for the even years between 1998 and 2008. Their index contains a few questions that are not present in the 2004 version of the CGI analyzed herein, such as those regarding the presence of institutional investors as relevant shareholders, the Chief Executive Officer (CEO) or Chief Finance Officer (CFO) not acting as the key investor relations person as well, or the timely filing of information with CVM. There are also minor differences in terms of the assignment of questions to subindices.

A lower cost of capital, or a higher market valuation, is an important benefit for the adopters of better corporate governance practices (Leal and Carvalho-da-Silva, 2007; Lima and Sanvicente, 2013; Black *et al.*, 2014). Leal and Carvalho-da-Silva (2007) and Black *et al.* (2014) report about the positive impact of corporate governance practices of Brazilian listed firm on their market valuations. They affirm that financial disclosure is the aspect of their respective corporate governance indexes with the greatest impact on shareholder value. Carvalho and Nobili (2011) use arbitrage portfolios and find lower valuations for firms with

low corporate governance scores. Lima and Sanvicente (2013) used the well-known Gordon model with perpetual growth in dividends to estimate the cost of equity. They find a significant negative relationship between the cost of equity and their corporate governance index and suggest that better-governed firms lower their cost of capital. They also conclude that the most important component of corporate governance practices is disclosure.

The next section describes the CGI and the methodology used to obtain the index. Section 3 describes the sample. Section 4 presents the empirical results about the evolution of the CGI from 2004 to 2013. Section 5 concludes.

2. A Corporate Governance Practices Index for Brazil

The use of broad firm-level corporate governance indices has become common in the international literature (Klapper and Love, 2004; Drobetz *et al.*, 2004; Bhagat and Bolton, 2008; Black *et al.*, 2012). In 2003, two of the authors developed an initial version of the corporate governance index (CGI) as a by-product of a project sponsored by the IADB (Leal and Carvalhal, 2005, 2007). The IBGC has supported the calculation of the CGI since 2004. The earlier version of the CGI was based on 24-question questionnaire. The IBGC-sponsored CGI contains 20 questions that resulted from a revision of the initial questionnaire and was validated by corporate professionals and IBGC staff.

The current CGI has 20 questions. They cover four broad dimensions: disclosure; board composition and functioning; ethics and conflicts of interest; and shareholder rights. These dimensions may be somewhat arbitrary but are helpful for presentation purposes. Each question has a “yes” or “no” answer. The question scores 1 if the answer is “yes”, otherwise the score is 0. We also score 0.5 to differentiate companies that partially adopt certain corporate governance practices in some questions. The index is the simple sum of the scores for each question. There is no weighing among questions. The maximum index value is 20. The CGI score is drawn from public information disclosed by listed firms, such as company filings, their FRs (the standard form for CVM filings since 2009), charters, and annual reports. We collect the data from the websites of the company, CVM, and BM&FBovespa. Table 1 shows the CGI questions and the criteria used to answer them. The questions are based on good corporate governance practices according to

international standards and recommendations of IBGC, CVM, and BM&FBovespa.

The use of an objective index to measure corporate governance practices avoids the biases present in subjective qualitative interviews or surveys. Those that volunteer to answer them may be the ones with the good answers. The reply rates of surveys and interviews may be low, rendering their representativeness questionable. The most important limitation of our objective approach is that we cannot ask everything we would like because we rely on public information availability to obtain our answers. Another limitation is that we cannot capture the nuances that transpire in interviews or surveys.

The remainder of this section provides a brief review of the literature associated with each of the four dimensions used for grouping questions.

Table 1 - Corporate Governance Index Questions Applied to Brazilian Companies

Each question corresponds to a “yes” or “no” answer. If the answer is “yes”, then the value of 1 (or 0.5) is attributed to the question, otherwise the value is 0. The index is the sum of the points for each question and was later scaled between 0 and 10. Index dimensions are simply for presentation purposes and there is no weighing among questions. All questions are answered from public information (company filings, charters, and annual reports).

Question	Answering Procedure and Scoring Criteria
Disclosure	
1. Does any company public document include information about policies and established mechanisms to handle conflict of interest situations and/or related party transactions?	Verify the FR, code of ethics or conduct, and corporate charter. The score is: 0 if the company does not disclose this information; 0.5 if the company discloses something about this information; 1 if the company discloses substantial information.
2. Does the company disclose compensation information for senior management and board members, separating the amounts paid to management and board, and the variable and fixed proportions?	Verify item 13 of FR. The score is: 0 if the company does not separate board and management and fixed and variable compensation; 0.5 if it separates board and management or fixed or variable; 1 if it separates board and management and fixed and variable.
3. Did the company present any opinion in the independent auditor's report in the last five years that was not unqualified?	Verify explanatory notes in the financial statements. The score is: 0 if answer is no; 1 if answer is yes.
4. Does the company website have an investor relations section containing its Annual Report?	The document must be clearly identified as the Annual Report from the previous year, must be in the Investors Relations area, and cannot be the Management Report, required by CVM. The score is: 0 if answer is no; 1 if answer is yes.
5. Does the company website contain the presentations made to securities analysts?	Presentations must refer, at least, to the last quarter of the previous year or previous year. The score is: 0 if answer is no; 1 if answer is yes.
6. Does the Annual Report include a specific section dedicated to the implementation of corporate governance principles?	Verify the Annual Report and website. The information must be substantial and not simply descriptive of board membership and ownership structure. The score is: 0 if answer is no; 1 if answer is yes.
Board Composition and Functioning	
7. Are the Board of Directors Chair and the CEO different persons?	Verify the FR. The score is: 0 if answer is no; 1 if answer is yes.

Cont. Table 1 - Corporate Governance Index Questions Applied to Brazilian Companies

8. Does the company have board committees reported in public information such as the corporate charter, annual report, website, FR?	Financial institutions must have an audit committee to comply with Central Bank regulation and those do not count for a positive score. The score is: 0 if answer is no; 1 if answer is yes.
9. Is the board only made up of outside directors, with the exception of the CEO?	Verify the FR. The score is: 0 if there are other managers in addition to the CEO; 1 otherwise. Changed in 2014 to: The score is: 0 if there are managers including the CEO; 1 otherwise.
10. Is the board size between 5 and 11 members, as recommended by the IBGC Code of Best Practices?	Verify the FR. The score is: 0 if answer is no; 1 if answer is yes.
11. Do board members serve consecutive one or two-year terms, as recommended by the IBGC Code of Best Practices?	Verify the FR. The score is: 0 if answer is no; 1 if answer is yes.
Ethics and Conflicts of Interest	
12. Is the percentage of non-voting shares in the total equity capital less than 20%?	Verify the FR. The score is: 0 if answer is no; 1 if answer is yes.
13. Is the percentage of voting shares of the controlling block equal or less than its percentage of all kinds of shares altogether?	Verify the company charter and shareholders agreement. The score is: 0 if answer is no; 1 if answer is yes.
14. Are loans to the controlling shareholder or other related parties prohibited in the company charter or shareholders agreement?	Verify the FR. The score is: 0 if answer is no; 1 if answer is yes.
15. Does the corporate charter facilitate shareholder participation in general meetings by not requiring the previous remittance of documentation proving the shareholder status and adopting the principle of good faith?	Verify the company charter. The score is: 0 if the company requires both the previous remittance of documentation proving the shareholder status and does not adopt the principle of good faith; 0.5 if it either requires the previous remittance of documentation proving the shareholder status or does not adopt the principle of good faith; 1 if answer is yes.
Shareholders Rights	
16. At least one of the affirmatives below is true: a) the company concedes one vote to each share, of any kind b) the company concedes the right to vote to non-voting shares in greater impact decisions	Verify the company charter. The score is: 0 if non-voting shares never vote; 0.5 the company concedes the right to vote to non-voting shares in greater impact decisions or if the company has only voting shares but presents voting limits per shareholder or golden shares; 1 if it abides to the one share, one vote, principle.
17. Does the company grant mandatory bid rights besides what is legally required?	The score is: 0 if no rights besides the legal rights are granted; 0.5 the company extend extra mandatory bid rights to either voting or non-voting shares, but not both; 1 the company extend extra mandatory bid rights to both voting and non-voting shares, if any.
18. Is the company control direct?	The score is: 1 if the direct controlling shareholder is an individual, institutional investor, foreign entity, the state, or a fully owned holding company of one of the previous owner types; 0 otherwise.
19. Do shareholders agreements abstain from directing or constraining the right to vote of any board member, or from appointing any senior manager?	Verify FR and shareholders agreements. The score is 0 if the answer is no; 1 if answer is yes.
20. Is the free-float equal or larger than 25%, as required by the premium listing segments of BM&FBovespa?	Verify the FR. The score is: 0 if answer is no; 1 if answer is yes.

2.1. Disclosure

The first CGI dimensions contains six disclosure of information attributes: (i) policies and mechanisms to handle conflict of interest and/or related party transactions; (ii) compensation, separating the amounts paid to senior management and board members, and its variable and fixed components; (iii) unqualified auditor opinion in the last five years; (iv) annual report available on the investor relations website; (v) corporate presentations available on the company website; and (vi) annual report with a specific section dedicated to corporate governance.

Greater disclosure usually leads to higher firm value and better overall corporate governance practices. Doidge, Karolyi and Stulz (2004) and Klapper and Love (2004) show that non-US firms that issue ADRs must comply with requirements that render them more transparent. Moreover, weak corporate governance practices are associated with more frequent related party transactions (Kohlbeck and Mayhew, 2010), higher executive compensation (Hermalin and Weisbach, 1991), and less prestigious external auditors (Michaely and Shaw, 1995). Leal and Carvalho-da-Silva (2007) and Black *et al.* (2014) point out that financial disclosure is the dimension of their respective indices with the largest impact on shareholder value, whereas Lima and Sanvicente (2013) claim the same for the cost of equity capital.

2.2. Board Composition and Functioning

The second dimension is board composition and functioning. The CGI questionnaire addresses five attributes: (i) separation between CEO and Chairman of the Board; (ii) existence of board committees; (iii) outside directors participation, excluding the CEO; (iv) board size between 5 and 11 members; and (v) consecutive board member terms of one or two years.

Yermack (1996) affirms that large boards are less effective than small boards. The IBGC suggests an ideal board size of 5 to 11 directors with two-year consecutive terms for board members. The presence of outside directors and the separation of CEO and Chairman are positively related to firm valuation (Rosenstein and Wyatt, 1990, Agrawal and Knoeber, 1996), and the presence of board committees enhances firm monitoring (John and Senbet, 1998).

2.3. Ethics and Conflicts of Interest

There is a vast literature on conflict of interests between controlling and outside shareholders. Shleifer and Vishny (1997), La Porta *et al.* (1998, 1999, 2000, 2002), Morck *et al.* (1988) and Claessens *et al.* (2000, 2002) show that the concentration of voting rights and the separation of voting (control) from cash flow (property) rights have a negative effect on firm valuation because of the potential expropriation of minority shareholders. Sternberg, Leal, and Bortolon (2011) showed that Brazil displays very high ownership concentration levels and Leal and Carvalhal-da-Silva (2007) found evidence that the deviation between control and ownership rights proportions destroys shareholder value. It must be noted that Brazilian voting (common) shares can only have one vote. Multiple votes per share are not allowed. Brazilian preferred shares might have one vote each, depending on the company charter. Usually, they do not carry voting rights but offer other rights, most commonly a higher dividend than voting shares.

We use four attributes related to ethics and conflicts of interest in this article: (i) the percentage of non-voting shares at less than 20% of the total equity capital; (ii) the percentage of voting shares held by controlling shareholders being equal or less than their percentage holdings of all shares; (iii) prohibition of loans to the controlling shareholder or other related parties; and (iv) waving the previous remittance of documentation or adopting the principle of good faith to facilitate shareholder participation in general meetings.

2.4. Shareholder Rights

The shareholder rights dimension contains five attributes: (i) one vote for each share or non-voting shares right to vote in high impact decisions, such as incorporations, spin-offs, and mergers; (ii) mandatory bid rights to minority shareholders beyond what is legally required; (iii) no indirect control structure; (iv) shareholders agreements abstention from directing or constraining the right to vote of any board member, or from appointing any senior manager; and (v) free-float equal or greater than 25%, as required by the premium listing segments of BM&FBovespa.

Shleifer and Vishny (1997) assert that granting voting and additional rights and incentives for minority shareholder participation are good corporate governance practices. Nenova (2006) reports that firm

valuations in a country are higher when its laws grant more rights (such as mandatory bid rights) to shareholders. Claessens *et al.* (2002) and Carvalho (2012) find that indirect ownership structures and shareholder agreements may expropriate minority shareholders and are negatively related to firm value. Gelman *et al.* (2015) assert that Brazilian shareholder agreements reduce shareholder value when they contain general stipulations that bind the vote of board members to the will of its signatories. Moreover, liquidity is positively associated with firm value and negatively associated with ownership concentration (Becht, Bolton and Röell, 2003).

3. Sample

Our sample consists of firms listed on BM&FBovespa from 2004 to 2013, which are, respectively, the first year that the 20-question questionnaire was used and the last year available when we concluded the latest scoring in October of 2014 and the writing of this article. Most companies file their previous year information with CVM usually between April and June and we collect the data during the second semester of the following year. Our annual samples do not include companies with incomplete or unavailable information, and firms whose shares were not traded in BM&FBovespa during each year.

Panel A of Table 2 shows that the number of firms per year ranges from 334 to 404. The sample size varies every year because of IPOs, delistings, mergers and acquisitions, and availability of information. The number of firms is higher between 2004 and 2007 due to the many IPOs in this period. In contrast, the number of firms has decreased since 2008, after the subprime and European debt crises.

4. Evolution of CGI Scores

4.1. Overall Corporate Governance Practices

Table 2 shows the average value of the CGI and its four subindices from 2004 to 2013 in a 0 to 10 scale. The average CGI score increased from 3.8 in 2004 to 5.8 in 2013. Conventional mean comparison tests (not reported here) show that these differences are statistically significant. The differences from 2004 to 2007 and from 2008 to 2013, in the hot IPO and the crises years, respectively, are also statistically significant. The CGI continued to improve even during the crises years. The creation of

Novo Mercado is possibly one of the drivers of these increasing CGI scores because most new listings took place in it after 2004.

Even so corporate governance practices have improved, the average CGI score of 5.8 out of 10 can be considered low because the CGI questionnaire addresses some corporate governance practices that are relatively easy to adopt, suggesting that there is room for improvement. Taking 2013 as an example, firms score very low in ethics and conflicts of interest (3.3) when compared to disclosure (6.6), board composition and functioning (6.4), and shareholders rights (6.3). The improvement from 2004 to 2013 was larger in disclosure (94% from 3.4 to 6.6), followed by shareholders rights (50% from 4.2 to 6.3), board composition and functioning (31% from 4.9 to 6.4), and ethics and conflicts of interest (22% from 2.7 to 3.3).

Table 2 - Overall Corporate Governance Practices

The table shows the number of firms in our sample and the average value of the corporate governance index (CGI) and its four subindices, scaled on a 0-10 range, from 2004 to 2013. CGI is a corporate governance index derived from 20 questions that are answered from public information (company filings, charters, and annual reports) detailed in Table 1. Disclosure, Board Composition and Functioning, Ethics and Conflicts of Interest, and Shareholder Rights are the four CGI subindices. The annual samples do not include companies with incomplete or unavailable information, and firms whose shares were not traded in BM&FBovespa during each year.

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
<i>Panel A: Sample size</i>										
Number of Firms	378	343	366	404	387	365	344	341	335	334
New Firms in Sample	-	10	54	57	4	23	12	15	11	0
Firms Leaving Sample	-	36	16	26	38	30	20	19	0	1
<i>Panel B: Averages</i>										
CGI	3.8	3.9	4.4	4.9	5.0	5.2	5.6	5.9	5.9	5.8
Disclosure	3.4	3.9	4.5	5.0	5.2	5.9	5.9	6.3	6.1	6.6
Board Composition and Functioning	4.9	5.1	5.3	6.2	6.2	6.3	6.4	6.6	6.6	6.4
Ethics and Conflicts of Interest	2.7	2.0	2.5	2.7	2.8	3.4	3.7	3.9	3.9	3.3
Shareholder Rights	4.2	4.4	4.8	5.2	5.3	4.9	6.0	6.5	6.7	6.3

Table 3 shows the average value of the CGI and its four subindices by listing segment in 2013, the most recent year in the sample. Over 50% of the sample was listed in the premium corporate governance segments of BM&FBovespa (38% in *Novo Mercado*, 9% in Level 1, and 6% in Level 2). As expected, the average CGI is much higher for firms listed in the premium corporate governance segments than in the traditional market. In general, the four CGI subindices lead to the same conclusion. The table includes the minute BovespaMais segment as well.

Table 3 - Overall Corporate Governance Practices by Listing Segment

The table shows the average value of the corporate governance index (CGI) and its four subindices (scaled to a 0-10 range) for 334 firms in 2013 by listing segment (*Novo Mercado*, Levels 1 and 2, *Traditional* and *BovespaMais*). CGI is a corporate governance index derived from 20 questions that are answered from public information (company filings, charters, and annual reports) detailed in Table 1. Disclosure, Board Composition and Functioning, Ethics and Conflicts of Interest, and Shareholder Rights are the four CGI subindices.

Index and subindices	Novo Mercado	Level 2	Level 1	Traditional	Bovespa Mais	Total Sample
CGI	7.7	6.4	5.8	4.2	6.1	5.8
Disclosure	8.4	8.5	8.3	4.6	4.7	6.6
Board Composition and Functioning	8.3	8.0	7.5	4.4	7.3	6.4
Ethics and Conflicts of Interest	5.4	1.1	1.2	2.3	5.0	3.3
Shareholder Rights	8.3	6.6	4.9	4.9	7.3	6.3
% of firms	38%	6%	9%	46%	1%	100%

Table 4 shows the average value of the CGI according to firm size ranges (gross annual revenue). Around 44% of firms have annual revenues higher than R\$ 1 billion. Our results suggest a positive relation between firm size and the quality of corporate governance practices. This is consistent with many international and Brazilian studies (Leal and Carvalho-da-Silva, 2007). Table 5 shows the average value of the CGI by industry (according to the Economatica database industry classification). Firms are widely distributed across industries and none concentrates more than 15% of the sample. The industries with more companies are energy (12%) and bank/insurance (10%). The software and data, transportation, and mining industries display the highest average CGIs (7.6, 7.1, and 7.0, respectively). On the other hand, textile, non-metal minerals, telecommunications, and electronics present the lowest CGIs (4.7, 4.8, 4.8, and 4.9, respectively).

Table 4 - Overall Corporate Governance Practices by Firm Size

The table shows the average value of the corporate governance index (CGI) and its four subindices (scaled to a 0-10 range) for 334 firms in 2013 by firm size ranges (gross annual revenue). CGI is a corporate governance index derived from 20 questions that are answered from public information (company filings, charters, and annual reports) detailed in Table 1. Disclosure, Board Composition and Functioning, Ethics and Conflicts of Interest, and Shareholder Rights are the four CGI subindices.

Annual Revenue (R\$)	CGI	% of firms
> 250 million	4.0	23%
250 to 500 million	5.7	9%
500 million to 1 billion	6.0	24%
1 billion to 5 billion	6.7	28%
5 billion to 10 billion	7.0	9%
> 10 billion	6.8	7%

Table 5 - Overall Corporate Governance Practices by Industry

The table shows the average value of the corporate governance index (CGI) and its four subindices (scaled to a 0-10 range) in 2013 by industry (according to Economatica database). CGI is a corporate governance index derived from 20 questions that are answered from public information (company filings, charters, and annual reports) detailed in Table 1. Disclosure, Board Composition and Functioning, Ethics and Conflicts of Interest, and Shareholder Rights are the four CGI subindices.

Sector	CGI	% of firms
Agricultural	6.9	1%
Bank and insurance	6.3	10%
Chemical	5.2	3%
Commerce	6.0	5%
Construction	5.9	6%
Electronics	4.9	2%
Energy	5.7	12%
Food and beverage	5.9	6%
Industrial machine	6.0	1%
Mining	7.0	1%
Non-metal minerals	4.8	1%
Oil and gas	6.1	2%
Others	6.1	24%
Pulp and paper	5.8	1%
Software and data	7.6	1%
Steel and metallurgy	5.1	6%
Telecommunications	4.8	2%
Textile	4.7	6%
Transportation	7.1	4%
Vehicle and parts	5.0	5%

4.2. Specific Corporate Governance Practices

Table 6 presents the average scores for each one of the 20 questions that make up the CGI questionnaire. The following sections analyze each corporate governance practice according to the four CGI subindices

(disclosure, board composition and functioning, ethics and conflicts of interest, and shareholder rights).



Table 6 - Percentage of Companies Scoring “Yes” to Corporate Governance Index Questions

The table shows the percentage of companies whose answer is “yes” to each question of the corporate governance index (CGI) questionnaire from 2004 to 2013. CGI is a corporate governance index derived from 20 questions that are answered from public information (company filings, charters, and annual reports) detailed in Table 1. All questions are answered from public information (company filings, charters, and annual reports) according to the criteria depicted in Table 1.

Question	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Panel A: Disclosure										
1. Does any company public document include information about policies and established mechanisms to handle conflict of interest situations and/or related party transactions?	31%	41%	53%	60%	60%	63%	63%	68%	59%	69%
2. Does the company disclose compensation information for senior management and board members, separating the amounts paid to management and board, and the variable and fixed proportions?	25%	38%	41%	36%	56%	89%	92%	93%	93%	93%
3. Did the company present any opinion in the independent auditor's report in the last five years that was not unqualified?	67%	69%	74%	78%	79%	84%	83%	83%	83%	84%
4. Does the company website have an investor relations section containing its Annual Report?	46%	55%	60%	67%	65%	67%	52%	62%	50%	40%
5. Does the company website contain the presentations made to securities analysts?	28%	31%	40%	48%	48%	53%	56%	64%	63%	65%
6. Does the Annual Report include a specific section dedicated to the implementation of corporate governance principles?	35%	41%	48%	56%	56%	60%	61%	70%	70%	71%
Panel B: Board Composition and Functioning										
7. Are the Board of Directors Chair and the CEO different persons?	65%	67%	68%	69%	71%	72%	70%	73%	77%	81%
8. Does the company have board committees reported in public information such as the Corporate Charter, Annual Report, website, FR?	14%	19%	21%	23%	26%	32%	41%	42%	42%	43%
9. Is the board only made up of outside directors, with the exception of the CEO?	74%	73%	77%	76%	77%	76%	71%	77%	74%	77%
10. Is the board size between 5 and 11 members, as recommended by the IBGC Code of Best Practices?	57%	60%	63%	68%	66%	70%	76%	75%	76%	76%
11. Do board members serve consecutive one or two-year terms, as recommended by the IBGC Code of Best Practices?	35%	34%	36%	73%	74%	78%	75%	77%	78%	81%
Panel C: Ethics and Conflicts of Interest										
12. Is the percentage of non-voting shares in total capital less than 20%?	30%	30%	40%	45%	46%	48%	53%	53%	52%	56%
13. Is the percentage of voting shares of the controlling block equal or less than its percentage of all kinds of shares altogether?	28%	26%	37%	43%	44%	46%	53%	51%	52%	53%
14. Are loans to the controlling shareholder or other related parties prohibited in the company charter or shareholders agreement?	0%	1%	1%	3%	3%	3%	7%	7%	5%	8%
15. Does the corporate charter facilitate shareholder participation in general meetings by not requiring the previous remittance of documentation proving the shareholder status and adopting the principle of good faith?	52%	49%	45%	39%	38%	37%	27%	32%	33%	33%
Panel D: Shareholders Rights										
16. At least one of the affirmatives below is true: a) the company concedes one vote to each share, of any kind b) the company concedes the right to vote to non-voting shares in greater impact decisions	20%	23%	35%	42%	43%	47%	51%	56%	57%	58%
17. Does the company grant mandatory bid rights besides what is legally required?	15%	21%	33%	43%	45%	51%	57%	60%	61%	62%
18. Is the company control direct?	29%	31%	33%	33%	36%	36%	39%	65%	72%	68%
19. Do shareholders agreements abstain from directing or constraining the right to vote of any board member, or from appointing any senior manager?	82%	79%	74%	74%	73%	72%	73%	71%	69%	69%
20. Is the free-float equal or larger than 25%, as required by the premium listing segments of BM&FBovespa?	68%	70%	72%	75%	76%	79%	66%	62%	64%	64%

4.2.1. Disclosure

Panel A of Table 6 shows that the proportion of companies that discloses some information about policies to handle conflict of interest situations and/or related party transactions increased from 31% in 2004 to 69% in 2013. Out of these 69% in 2013, 46% of companies score 0.5 in this question (disclose some information) and 23% score 1.0 (disclose substantial information).

The disclosure of compensation, separating the amounts paid to senior management and board members, and the variable and fixed proportions, has increased substantially since 2009, when it became mandatory to report it in the FR. Only 25% of companies disclosed detailed compensation in 2004, whereas 93% reported it in 2013. In 2008, the year before mandatory disclosure, this percentage reached 56% of sampled companies. It is worth noting that there still are companies that do not disclose the legally required information. Most of them probably take advantage of a court injunction secured by an organization representing financial executives that claims that senior managers are at greater risk of kidnapping if their companies report the maximum compensation, as required in the FR (Barros *et al.*, 2015).

Most companies present an unqualified opinion from independent auditors in the previous five years. There has been improvement in this practice and the percentage of firms with unqualified auditor opinion increased from 67% in 2004 to 84% in 2013. Even so, the number of companies with qualified auditor opinions seems high at 16% of listed companies.

On average, 55% of listed companies published the annual report on their investor relations website in the 2004-2013 period. This number fluctuated throughout the years, ranging from 40% in 2013 to 67% in 2009. There is still room for improvement on this practice because 60% of the companies did not publish annual reports on their website in 2013. Some possible reasons for this low number may be: (i) companies do not prepare annual reports; (ii) companies prepare annual reports but do not disclose them on the website, and (iii) companies disclose annual reports on the website with long delays (usually we collect the data to score the CGI after 6 to 10 months of each year-end).

Many companies (65% in 2013) disclose presentations made to securities analysts on their website. Only 28% of companies disclosed corporate presentations on their website in 2004. There should be room for improvement because companies that list their shares on

BM&FBovespa should meet regularly with market analysts. The annual reports of most firms include a specific section dedicated to the implementation of corporate governance principles. The number in 2013 (71% of listed companies) is significantly higher than in 2004 (35% of companies), demonstrating a major improvement on this simple practice over time.

4.2.2. Board Composition and Functioning

The Chairman of the Board and the CEO are not the same person in most companies (65% of companies in 2004 and 81% in 2013) according to Panel B of Table 6. An average of 70% of companies had different people as Chairman and CEO in the 2004-2013 period and there was an increase over the years, especially after 2011, when this rule became mandatory for companies listed on *Novo Mercado* and Levels 1 and 2. Even though this figure has always been relatively high in the period, this does not necessarily mean that outside professionals manage companies. It is customary that the most powerful person in the company, the largest shareholder, prefers to be at the board and maybe have a professional or younger family member as CEO, as suggested by Pinto and Leal (2013).

The use of board committees (audit, compensation, strategy, corporate governance, etc.) still seems low in Brazil. Even though the number of companies with board committees increased over time (14% in 2004 to 43% in 2013), almost 60% of listed companies do not display committees. The absence of formally constituted committees may suggest a certain lack of board structure and sophistication. The largest shareholders may still dominate boards. Table 7 details the presence of board committees, as declared by companies in their public documentation. The most frequent board committee is human resources-compensation-evaluation (30%), followed by audit (29%), finance-tax-investment (16%), risk-internal control-compliance (12%), strategy (12%), and corporate governance (9%).

Table 7 - Presence of Board Committees in Brazil

The table shows the percentage of companies that declared board committees (audit, compensation, strategy, corporate governance, etc.) from 2004 to 2013.

Board Committee Type	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Human Resources, Compensation, or Evaluation	4%	7%	8%	12%	14%	19%	23%	26%	29%	30%
Audit	9%	14%	13%	14%	17%	21%	23%	27%	28%	29%
Finance, Tax, or Investment	4%	6%	5%	5%	7%	10%	17%	14%	17%	16%
Risk, Internal Control, or Compliance	2%	4%	3%	4%	5%	9%	13%	12%	11%	12%
Governance	1%	2%	3%	3%	5%	8%	9%	10%	10%	9%
Strategy	2%	2%	4%	4%	5%	6%	7%	7%	8%	12%

Panel B of Table 6 shows that outside directors comprise most boards (77%) if the CEO is not considered. The percentage of companies with outside directors is relatively stable over time, ranging from 71% in 2010 to 77% in 2013. At first glance, this number may seem surprisingly high in a country where controlling shareholders have the power to indicate senior management, but maybe this is the reason why major shareholders prefer to nominate boards with trusted people outside the executive team, including other family and control coalition members. It is important to note that we are not analyzing the presence of independent board members, but their proportion is still low, as indicated by Brugni *et al.* (2013). Moreover, when our CGI design and data collection initiated, companies did not identify directors as independent.

Board sizes between 5 and 11 members are very common (76% of the firms in 2013). The percentage of companies with adequate board size increased from 57% in 2004 to 76% in 2013. Besides the improvement on this practice, this increase is also due to changes in the scoring criteria for this question. The revised IBGC Code of Best Practices increased the maximum recommended board size from 9 to 11 in 2009 and the questionnaire scoring criteria changed accordingly.

Nowadays, board members usually serve consecutive one or two-year terms. In 2004, only 35% of companies had board terms according to IBGC rules, but the frequency increased to 81% in 2013. The IBGC Code of Best Practices recommended consecutive board terms of 1 year before 2009. The 2009 revised code increased the recommended term to 2 years. The break in the series in 2007 is due to a change in the scoring criteria implemented by request of IBGC even before they changed their code.

4.2.3. Ethics and Conflicts of Interest

The use of control enhancement mechanisms such as non-voting shares and the deviation between control and ownership rights has decreased in Brazil, as Sternberg *et al.* (2011) pointed out, and is a remarkable improvement. Even so, our results show a high degree of voting concentration and a considerable difference between the percentage of voting and total equity capital held by large shareholders, consistently with Leal and Carvalhal-da-Silva (2007) and Sternberg *et al.* (2011), among others. Even though there still are many companies with non-voting shares, there was a substantial increase in the proportion of companies with less than 20% of non-voting shares in their equity capital. This percentage went from 30% of companies in 2004 to 56% in 2013 but stabilized after 2010. Most new listings joined *Novo Mercado* after 2004, which bars non-voting shares, but new issues dwindled after 2010. Only 28% of companies exhibited controlling shareholders with ownership percentages of the voting capital equal or less than their percentage in the total equity capital in 2004. This figure increased considerably to 53% by 2013. This evolution suggests a better alignment of the interests of the largest and minority shareholders.

On the other hand, forbidding loans to controlling shareholders or related parties is rare among Brazilian companies. Only 8% of them do so in their charter or shareholders agreement. Despite a small improvement in recent years, this is, by far, the corporate governance practice with the lower percentage of adopting companies in the CGI questionnaire and an aspect that needs improvement.

Most Brazilian listed companies do not facilitate shareholder participation in general meetings and there is much bureaucracy. Only one third of the companies did not require previous remittance of documentation to confirm the shareholder status and/or adopt the principle of good faith. Out of the 33% of companies that facilitated the voting process in 2013, only 1% displayed both practices (no need to send documentation and adoption of good faith). This is another area that needs refining.

4.2.4. Shareholder Rights

The proportion of companies with their equity capital comprised solely of voting shares or that grant voting rights to non-voting shares in special circumstances (incorporations, spin-offs, mergers, and contracts

between the company and related parties) increased considerably from 20% in 2004 to 58% in 2013. This is a remarkable departure from a market dominated by non-voting shares before the new listings wave in *Novo Mercado*. Exclusive issuance of voting shares (49% in 2013) is more common than granting voting rights to non-voting shares (9% in 2013).

The number of companies granting mandatory bid rights besides what is legally required has increased considerably in recent years. The Brazilian securities law requires that acquirers pay 80% of the bid made for the controlling bloc to voting minority shareholders. Non-voting shareholders do not enjoy this legal right. Extra bid rights include a percentage greater than 80% of the bid for the controlling bloc for minority voting shareholders and/or extending this right, at any percentage, to non-voting shareholders. Only 15% of companies granted extra mandatory bid rights in 2004. This number increased to 62% in 2013. Most importantly, there was a substantial increase in the companies granting mandatory bid rights to all shares. A mere 8% (out of 15%) of companies granted mandatory bid rights to all shares in 2004, whereas 60% (out of 62%) granted these rights to all shares in 2013.

Indirect control structures may be used to separate control from ownership rights in addition to using non-voting shares, as discussed in Aldrichi and Postali (2011) and Bortolon (2013). The percentage of Brazilian listed companies with no indirect control structure increased from 29% in 2004 to 68% in 2013. A change in the scoring criterion for this question caused a break in this series in 2011. Companies scored “0” if they had any type of indirect control structure before 2011. After 2011, companies scored “0” only if they had an indirect control structure that was used to enhance control. For example, a company would score 1 if it had an indirect structure in which the controlling shareholder kept the same voting power directly and indirectly.

The use of shareholders agreements is common in Brazil and is another way to enhance control rights because they may contain provisions that restrict the voting rights of shareholders and board members that represent their signatories and determine the way controlling shareholders allocate board seats (Gelman, Castro e Seidler, 2015; Carvalho, 2012; Sternberg *et al.*, 2011; Bianchi *et al.*, 2001). The percentage of companies with shareholders agreements that abstain from directing or constraining the right to vote of any board member, or from appointing any senior manager, decreased from 82% in 2004 to 69% in

2013. This practice has not improved over time. Firms are using more shareholder agreements to govern the relation between shareholders possibly as a consequence of the reduction of ownership concentration since 2004 pointed out by Sternberg *et al.* (2011), among others.

An acceptable level of market liquidity is very important to minority investors. *Novo Mercado* requires a free-float equal or greater than 25%. Most companies listed in the traditional segment of the exchange may offer inadequate liquidity. On average, 70% the companies had this minimum free-float between 2004 and 2013. This percentage did not change significantly over the years, ranging from 62% in 2011 to 79% in 2009.

4.2.5. Other Corporate Governance Practices

We scored four additional corporate governance practices that are not part of the CGI questionnaire. They are the number of board meetings per year, the existence of a policy on insider stock trading, the presence of poison pills, and the disclosure of the minimum, average, and maximum of individual senior management and board compensation. This information became available from 2009 with the introduction of the FR. Table 8 shows the evolution of these four corporate governance practices up to 2013.

The IBGC Code of Best Practices recommends 4 to 12 board meetings per year. On average, 73% of the listed companies complied with this standard. Specifically, 43% of the companies hold 4 or 5 board meetings per year and 30% from 6 to 12 meetings per year.

The disclosure of the company policy on insider stock trading increased considerably after BM&FBovespa required that all companies listed on *Novo Mercado*, Levels 1 and 2 publish them together with codes of conduct in 2011. The disclosure of this policy as well as the stock trades by corporate insiders and controlling shareholders are considered good corporate governance practices. The percentage of companies disclosing a policy on insider stock trading increased from 56% in 2009 to 68% in 2011 and 74% in 2013.

Poison pills are important takeover defense mechanisms (Schwert, 2000; Field and Karpoff, 2002). The percentage of companies that do not have poison pills is relatively stable over time, ranging from 80% in 2010 to 86% in 2013. Brazilian poison pills are not like US poison pills. They usually refer to the inclusion of a mandatory bid right in the charter that

requires the acquirer of company stock to bid for all the remaining stocks beyond a certain threshold (commonly 20 to 30%). The charter may define the minimum bid, such as 150% of the current market price, and the conditions for poison pill removal, sometimes also requiring a mandatory bid for all shares from those willing to remove this charter provision.

CVM does not require the disclosure of individual compensation. Instead, companies must report the average, minimum, and maximum individual compensation of senior managers and board members on the FR. Even though the frequency of companies reporting this information has increased from 63% in 2009 to 72% in 2013, 28% of the listed companies in Brazil did not follow this CVM rule in 2013. The most likely reason is that they avail themselves of a court injunction in order to avoid the publication of the average, minimum, and maximum individual compensation, as described in Barros *et al.* (2015).

Table 8 - Companies Scoring “Yes” in Other Corporate Governance Practices

The table shows the percentage of companies that scored “yes” to four additional corporate governance practices that are not included in the corporate governance index (CGI) questionnaire: number of board meetings per year; policy on stock trading; presence of poison pills; and disclosure of the minimum, average, and maximum of individual senior management and board compensations. These scores are available from 2009 to 2013. All questions are answered from public information (company filings, charters, and annual reports).

Practice	2009	2010	2011	2012	2013
Number of board meetings between 4 and 12 per year	71%	72%	72%	71%	73%
Disclosure of policy on stock trading	56%	56%	68%	71%	74%
No poison pill	84%	80%	85%	85%	86%
Disclosure of minimum, average, and maximum compensation	63%	72%	75%	76%	72%

5. Conclusion

This article analyzes several Brazilian corporate governance aspects gathered in a corporate governance index (CGI) from the year the first IPO in *Novo Mercado* (2004), through the IPO wave years (2004-2007), and the international crises years (2008-2013). It offers some insights on what advanced as well as highlights some areas that need more attention and, as a by-product, offers many recent references to recent research about Brazilian corporate governance practices. The CGI contemplates several corporate governance and disclosure attributes, which are not legally required but considered good practices by international and Brazilian standards. The CGI score is attained by means of a 20-question questionnaire.

The CGI is much higher for firms listed on premium listing segments (*Novo Mercado*, Levels 1 and 2, and BovespaMais) of the stock

exchange, which demand that companies that voluntarily join them adopt certain corporate governance and disclosure practices in addition to what is legally required. There is also a positive relation between firm size and the quality of their corporate governance practices. Moreover, our results show that software and data, transportation, and mining are the industries with the best corporate governance practices, whereas textiles, non-metal minerals, telecommunications, and electronics present the lowest CGI scores.

The overall quality of corporate governance practices in Brazil has improved since 2004. However, the average scores of the CGI and its four subindices are still relatively low and may improve even further. Company scores are very low in the ethics and conflicts of interest subindice if compared to the disclosure, board composition and functioning, and shareholders rights subindices.

We also offer an analysis of the CGI evolution according to each individual question in the questionnaire used for scoring. Companies improved in several aspects under the disclosure group of questions. This may be due to new listings in *Novo Mercado* as well as the new disclosure regulation introduced in 2009. There was also an evolution in some board practices, notably in the number of board members within the 5 to 9 range, but the use of committees is still relatively low. Seventy-three percent of the companies hold between 4 and 12 board meetings per year. The new *Novo Mercado* listings contributed to a remarkable reduction in the percentage of non-voting shares in the equity capital and in the difference between control and ownership rights held by the largest shareholders. On the other hand, the number of companies that explicitly forbade loans to related parties and reduced formalities to facilitate participation in shareholder meetings is still small are aspects that need improvement. Finally, even though the number of companies that grant extra mandatory bid rights in favor of minority shareholders increased and the use of indirect control structures decreased, major shareholders leveraged their control rights by means of greater use of shareholder agreements that interfere in board member nomination and independent voting. Thus, as some control enhancement mechanisms receded, this one became more common.

Most companies disclose their policy about insider stock trading and do not have poison pills in their charter. Yet, some companies rebelled against the regulation requiring disclosing the maximum individual compensation among senior managers and directors. Twenty-eight

percent of them did not report detailed compensation information. Most probably shielded by a court injunction in which the plaintiffs claim that they are at a greater risk of kidnapping if they comply with this rule.

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