

Corporate Governance: International Standards and Empirical Evidence in Brazil during the 1990s*

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ABSTRACT

This article aims to develop the viewpoint of the corporation as a ‘governance structure’, as well as to analyze the relationships that result from the separation between ownership and management. In this way, changes in stockholding control of the 100 largest non-financial corporations in Brazil over the period 1990 to 1997 are analyzed using methodology developed by Thomsen and Pedersen (1995) of the Copenhagen Business School, disregarding whether this control is in the hands of the Brazilian private or public sector, or foreign companies. The article also aims to compare the Brazilian experience with those observed in developed economies. In the Brazilian case, a new form of corporate control – *shared control* – has emerged as the model for a significant proportion of large companies whose main stockholders are institutional investors, both domestic and foreign.

*The author wishes to thank the economist and temporary staffer, Pedro dos Passos, as well as his colleagues from the Planning and Credit Departments of the BNDES.

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1. Introduction

One of the possible ways of examining the transformations undergone by the Brazilian economy in the 1990s is to focus on changes in corporate control in the largest corporations. A new form of control – *shared control* – has emerged as the dominant model in a significant proportion of these, notably where the stockholders are institutional investors, whether domestic or foreign. The nature of ownership and the identity of a company’s stockholders will evidently affect that company’s performance, since its strategic positioning depends on the alignment of interests of contracting parties. One theory that can be used to examine questions of such control in depth is the ‘Theory of Corporate Governance’, which seeks to analyze the mechanisms by which corporations are controlled.

Corporate governance concerns the control and monitoring systems established by the controlling stockholders of a given company with the aim of assuring that its managers take decisions on allocating resources that are in accordance with their interests. Questions of corporate governance acquired a greater relevance with the rise of the modern corporation, in which there is a separation between ownership and control. The theory of such issues originated in the 1930s, in the work of Berle and Means, which considered the classical problem of the *theory of agency*. During the same period, Coase published the principles of the *economics of transaction costs*, that is, how companies define the proportions of raw materials that they produce themselves and that they purchase in the market. This evidently has a bearing on the degree of verticalization for

which a firm should aim. In the 1970s, after having been ignored for some 40 years, the contractual basis of economic relations met with renewed interest in both academic and financial circles.

A series of studies is being carried out within the New Institutional Economics (NIE) paradigm, which emphasises the role in development played by institutions. The configuration taken by institutions, whether these are companies or the market itself, affects the performance of economic systems, as well as the outcome of competition between their constituent agents. In attempting to take an interdisciplinary path, the NIE is open to legal questions (regarding the economics of property law), administrative questions (regarding the theory of organizations), and historical questions (regarding the evolution of organizations), and takes explicit account of the fact that customs, the legal environment and the enforceability of rights have an impact on economic performance. For this reason, the program forms an interesting theoretical instrument for analyzing the Brazilian economy and its constituent agents, given that the transformations in progress during the 1990s have been of a largely institutional nature.

This article thus sets out to analyze changes in the stockholding control of the 100 largest non-financial corporations in Brazil over the period 1990-97, regardless of whether these were under domestic private or public, or foreign control. The article also attempts to compare the Brazilian experience with patterns of ownership observed in developed economies, using the classification methodology for corporate control developed by Thomsen and Pedersen (1995 and 1997) of the Copenhagen Business School.

This analysis must take into account the fact that the growth of the Brazilian economy has, since the 1930s, rested on the classic three pillars of private Brazilian, public Brazilian and foreign capital. Each kind of investor tended to specialize; the Brazilian public sector concentrating on infrastructure and raw materials; domestic private capital on agriculture, banking, commerce and light industry, while foreign capital tended to concentrate on consumer goods with a higher technological content. Despite the fact that growth rates have varied over time, it is possible to observe a long growth cycle from the 1930s to the start of the 1980s, allowing the country to develop a diversified and relatively modern industrial base. The guiding light for this process was import substitution, with the progressive emergence of domestic industries as and when the state of the balance of payments indicated a need for their development. This environment favored large state-owned companies reporting to their owners (the government), private companies under family control, and subsidiaries of foreign companies, all of which, despite wide variations in performance, operated within an economy where competition was 'controlled'.

Following the 1980s, a decade characterized by monetary instability, low growth and an adverse external environment, at the start of the 1990s, new factors began to affect the Brazilian economy. A process of opening to foreign trade was initiated, that introduced new standards of consumption and production, the role of the state was redefined, with the launch of a privatization program that transferred US\$ 37.6 billion of assets between 1991-97. With the achievement of monetary stability from 1994 onwards, the expansion

of the domestic market increased the attractiveness of the Brazilian economy in the context of a world economy undergoing profound transformations. This manifested itself in a sharp increase in inflows of foreign capital following the Real Plan.

These structural changes, liberalization, privatization and stabilization, redefined the conditions of competition. The protectionist environment that had previously existed had led to a form of behaviour by domestic entrepreneurs that was relatively timid, both in terms of their concern to promote technological development, and improve product and service quality, and in their general approaches to management. The liberalization of foreign trade increased the permeability of the domestic market, particularly with regard to tradable goods, and thus raised the degree of competition. At the same time, the withdrawal of the state from the industrial sector, as well as from important areas of the service sector, opened up a wide range of opportunities to both domestic and foreign investors.

In this way, the Brazilian state is in full retreat as a producer of goods and services, even if it is acquiring a series of important regulatory roles. Companies that were under public control until the 1980s and operated in sectors such as steel, paper and pulp, fertilizers, chemicals and petrochemicals, rail freight and mining, now have new owners. Domestic private companies under family control are under severe pressure, both because of the difficulties of establishing an adequate capital structure, with a greater proportion of equity financing, and due to the inherent increase in competition in a more open economy. New agents have grown in importance as the strategic controllers of large domestic companies: institutional investors, most notably pension funds, and foreign investors. A series of new stockholding arrangements have been reached that include such agents, and that represent the presence of new forms of corporate governance in the Brazilian economy.

Section 2 thus presents the theoretical ideas underlying the notion of corporate governance, using concepts relating to the structure of governance and contracts developed within the context of the NIE. Section 3 presents the results of Thomsen and Petersen's study (1995) of 12 European countries, as well as the United States and Japan. Section 4 uses the same methodology as the above study to present results obtained for Brazil regarding the period 1990-97, while Section 5 draws together a series of conclusions.

2. The Firm as a Governance Structure

Neoclassical theory does not consider the stockholding structure of a corporation, since it assumes that for a given technology (production function), firms will always seek to maximize performance, regardless of their associated ownership rights, and the legal form of constitution of these. This imposes on the firm the essentially passive role of transforming raw materials into products, without any effect on its competitors, a viewpoint that avoids the need to consider any management strategy beyond the 'mechanical' maximization of profits.

Within the NIE and Economics of Organizations paradigms, however, the firm is regarded as a governance structure [Williamson (1996)], or even as a ‘contractual nexus’ (Jensen and Mecklin). As a governance structure, the firm tends to internalize transactions in so far as these depend on specific assets. In the same way, therefore, as transactions differ in their characteristics (frequency, uncertainty and degree of specificity), governance structures vary in their level of operating costs and areas of responsibility, between individual firms, for example, and the market. According to Williamson, a firm should aim to align its transactions with its corresponding governance structures (whether hierarchical, contractual or market-based) in such a way as to minimize transaction costs.

Numerous studies have analyzed the implications (costs) of alternative ownership structures. Structures that vary in terms of their stockholding structure form part of the institutional organization of production. The classical problem that arises from the separation of ownership and management is dealt with in the literature of economics through the *theory of agency*.

The theory of agency, or of the principal agent, is one of the cornerstones of the *theory of contracts*, together with the theory of transaction costs, and relates not only to the asymmetry of information between agents, but also to property rights and contracts. Property rights affect incentives, in so far as the problem of agency, for example, is related to the transfer of rights of decision making by the principal agent. The theory of agency gains in importance to the extent that it contains the basic elements of contracts that arise within and between organizations. Sappington (1991, p. 64) holds that:

“Certainly, simple principal-agent models by themselves do not provide a complete understanding of the structure and operation of complex organizations. The models do seem helpful, though, both in identifying some possible sources of friction within organizations and in exploring efficient ways to mitigate these frictions.”

The *theory of agency* is concerned with a form of economic relationship that arises frequently within economic systems, namely the bilateral relationship between one individual (the principal) and another (the agent), where three necessary conditions are present:

- a) the agent can choose between several courses of action, or for example, in a corporation, the administrators are those individuals who hold effective control over its assets, and may use them in distinct ways;
- b) the actions of agents/administrators affect not only their own well-being (stability, growth), but also those of the principal/controlling stockholders (increases in share price, dividends);
- c) it is difficult for the principal to observe the actions of the agent, there being an asymmetry of information between the two parties.

In this way, it may be claimed that principal agent theories are mainly concerned with analyzing how an individual (the principal) establishes a system of compensation (contracts) that motivate another individual (the agent) to act in accordance with the former party's interests [Siffert (1996)]. Such theories also consider the difficulties of monitoring the agent's activities. Questions relating to the principal agent are thus central problems of the *economics of incentives*.

The question that regards corporate governance itself is as follows: how is it possible to establish a monitoring system under which the administrators manage companies in accordance with the interests of stockholders? Developed economies have arrived at two kinds of model: the German-Japanese approach, whereby the control of corporations is exercised principally through internal mechanisms consisting of cross-holdings, in which banks, insurers and other kinds of corporations take stakes, and the Anglo-Saxon approach, whereby stockholding control is fragmented, and control is exercised externally through the capital markets [Lethbridge (1997)]. In the latter kind of model, share prices represent the market's judgement, however subjective this may be, of the performance of administrators and the companies that they manage.

The debate between the two models becomes relevant when attempts are made to associate corporate governance structures with competitive performance. The experience of the last 20 years shows that positions adopted are colored by the performance of the national economies associated with the respective models of corporate governance. At the end of the 1980s, the strong performance of the Asian economies, and notably of Japan, distinguished the model adopted in that country. More recently, after over six years of economic growth in the United States, the American model, characterized by external control has again begun to find favor. The recent crisis of the Asian economies has also shown the ineffectiveness of internal monitoring mechanisms in those economies in controlling the expansionist drive on the part of managers, who, in a number of cases, produced companies with extremely high levels of leverage.

Corporate governance is thus a system for introducing mechanisms for regulating the actions of administrators (including the degree to which they leverage the capital structure of companies), a task that can be achieved by stockholder action or by the banking system itself, using risk analysis. According to Thomsen and Pedersen (1997), the ownership structure is one of the key determinants of corporate governance. There are reasons for this, as Williamson (1996) highlights:

- a) the concentration of ownership in the hands of large investors acts as an incentive for such investors to take an active role and interest in the performance of a corporation, as well as in the implementation of mechanisms for monitoring its administrators, that is to say, investors are encouraged to make their voices heard, rather than to plan escape routes;
- b) where administrators own shares in a corporation, these holdings will act as an incentive to maximize stockholder value rather than pursue their own objectives;

- c) the identity of stockholders gives an indication of their priorities. State-owned companies, for example, tend to follow political directives;
- d) according to the theory of finance, stockholders/owners who have diversified portfolios will not be adverse to the taking on of further risk by the corporation, whereas owners with a large proportion of their net worth in a single firm will be more inclined to follow low-risk strategies;
- e) the liquidity of holdings will affect the temporal preferences of stockholders, as well as the investment behaviour of corporations;
- f) integrated ownership structures (hierarchies) can reduce the costs of co-ordinating transactions involving very specific assets.

According to Demsetz (1967), the behaviour of agents is affected by property rights, which have an impact on the use and allocation of resources. Such rights must be seen as social instruments whose main aim is to aid economic agents in maintaining their expectations and formulating strategies while they negotiate with other such agents.

Firms may thus be seen as governance structures through which transactions are carried out, whose attributes demand a hierarchical system of co-ordination. According to Williamson (1990, p. 8):

“Holding the activity to be organized constant, the object is to assess the efficacy of alternative means of contracting. Interfirm contracting is well suited for some transactions; intrafirm contracting is well suited for others. Hybrid modes are superior in still others. The object is to establish which transactions go where.”

Governance structures, or rather, the organizational structure through which transactions are conducted (managed) may only be defined when the attributes of transactions have been clarified. Corporate governance is, for its part, concerned with a specific theme: the control of corporations. In this way, identifying ownership structure is a necessary first step towards the formation of an image of strategic movements.

3. Varieties of Corporate Control: International Evidence

Thomsen and Pedersen (1995), both of the Institute of International Economics and Management of the Copenhagen Business School, analyze corporate ownership in 12 European countries (Britain, France, Germany, Italy, Sweden, the Netherlands, Finland, Denmark, Norway, Austria and Belgium), as well as in Japan and the United States, taking as a reference the 100 largest non-financial companies in each country in 1990, and classifying these according to the criteria presented in Table 1, which defines six categories of ownership.

Table 1
Categories of Ownership

Category	Concentration of Ownership
1. Dispersed Ownership: where no entity or individual owns more than 20% of a company's voting stock.	Low
2. Dominant Minority Ownership: where a single stockholder, whether an individual, a family or a company, owns between 20-50% of the voting stock.	Medium
3. Family Ownership: when one person or family owns the majority (i.e. >50%) of the voting stock. This category also includes foundations, as these reflect the desire on the part of founders to transfer some degree of control to their families.	Alta
4. State Ownership: where the government (at either local or national level) owns the majority of the voting stock.	High
5. Foreign Ownership: where a foreign multinational owns the majority of the voting stock.	High
6. Cooperatives: where a company is registered as a cooperative, or where, in certain cases, the majority of the voting stock belongs to a group of cooperatives.	Low

Source: Petersen and Thomsen (1995).

The different categories of ownership vary by degree of concentration of ownership, as well as the origin of the investment capital (foreign, public sector, family, etc.). It should be pointed out, as Dietl (1998) does, that in the absence of cross-holdings, all shares, excepting those held by foreign investors, are directly or indirectly held by families/domestic citizens. The form and degree of intermediation of ownership is what varies from country to country.

Table 2 shows that intermediation of property, defined as cumulative stockholdings of banks, insurers, mutual funds, and domestic non-financial companies, that is to say, all economic agents excluding direct holdings by families, represented 64% of total share capital in Germany, 68.6% in Japan and 43% in the United States.

Table 2
Ownership Structures for Quoted Companies in Germany, Japan and the United States
(In %)

	Germany (1990)	Japan (1994)	United States (1992)
Families	17	23.5	49.8
Banks	10	22.2	0.3
Insurers	12	17.0	5.0

Pension Funds	N/a	1.6	29.2
Mutual Funds	N/a	-	9.0
Investment Companies	-	2.6	-
Holding Companies	-	1.4	0.3
Non-Financial Companies	42	23.8	N/a
Public Sector Companies	5	0.5	0.0
Foreign Investors	14	7.4	6.3

Source: Dietl (1998, p. 123).

It should be noted that the high share of stockholdings owned by families in the United States does not imply that the relevant corporations are under family control, but that, on the contrary, the ownership of large corporations is highly fragmented, with a large proportion of the population owning small blocks of shares. The significant proportion of total holdings of U.S. shares in the hands of pension funds should also be noted.

Table 3 shows the degree of concentration of ownership in Germany, Japan and the United States, taking the holding of the largest stockholder as a benchmark.

Table 3
Concentration of Ownership in Germany, Japan and the United States

Percentage (x) of voting capital controlled by largest stockholder	Germany^a (1994)	Japan^b (1995)	United States^c (1994)
0 < x < 10	3.2	61.1	66.0
10 < x < 25	6.9	21.3	17.4
25 < x < 50	16.7	12.9	13.0
50 < x < 75	31.9	4.7	2.1
75 < x < 100	41.3	-	1.5

Source: Dietl (1998, p.124).

^aInformation for Germany based on the 550 largest quoted and unquoted companies.

^bInformation for Japan based on all of the 1,321 Japanese *kabushiki-kaisha* listed on the Tokyo, Osaka and Nagoya stock exchanges.

^c Information for the United States based on all of the U.S. corporations listed under the S&P 500, the S&P MidCap 400 and the S&P SmallCap 600.

Dietl (1998) shows that while 41.3% of the 500 largest quoted and unquoted German companies have dominant stockholders with over 75% of the total voting capital, the corresponding figure for the U.S. company universe is only 1.5%, and for the Japanese universe, zero. On the other hand, for over 60% of the largest companies in the United States and Japan, there is no single stockholder that owns more than 10% of the total voting capital. The concentration of ownership is thus notable in Germany, where some 75% of the largest companies have over 50% of the total voting capital. While concentration of ownership is also high in Japan, intermediaries, most notably banks and insurers, carry more weight.

According to Thomsen and Pedersen (1995), there are three principal aspects of ownership: a) the identity of the majority stockholder, b) the concentration of ownership, or the stake held by the principal owner and c) the legal form of the company itself.

Table 4 shows, for a series of European countries, the classification of the 100 largest non-financial companies in each country, according to the methodology of categories of ownership presented in Table 1.

Table 4
Ownership of the 100 Largest Non-Financial Companies in 12 European Countries - 1990
(% Share of Total Revenues of the 100 Largest Companies in Brackets)

	Dispersed Ownership	Dominant Minority Ownership	Family Ownership	State Ownership	Foreign Ownership	Cooperative Ownership
Austria	0	7 (4.7)	25 (17.9)	20 (33.9)	38 (33.5)	10 (9.9)
Belgium	4 (7.7)	20 (28.5)	6 (7.8)	6 (8.2)	61 (46.7)	3 (1.0)
Denmark	10 (11.5)	9 (6.5)	30 (30.1)	11 (13.2)	23 (18.9)	17 (19.9)
Finland	12 (9.9)	25 (35.3)	23 (11.1)	19 (27.6)	11 (4.6)	10 (11.5)
France	16 (17.7)	28 (25.4)	15 (9.4)	22 (36.4)	16 (9.7)	3 (1.3)
Germany	9 (15.7)	30 (40.5)	26 (17.3)	10 (8.8)	22 (16.1)	3 (1.6)
England	61 (59.6)	11 (13.8)	6 (4.8)	3 (2.4)	18 (18.9)	1 (0.5)
Italy	0	22 (32.0)	20 (16.7)	29 (37.9)	29 (13.5)	0
Holland	23 (47.4)	16 (12.3)	7 (5.4)	7 (3.4)	34 (27.1)	13 (4.4)
Norway	6 (8.3)	14 (12.7)	29 (15.2)	13 (39.1)	19 (15.9)	19 (8.8)
Spain	6 (6.2)	22 (23.0)	8 (7.4)	14 (27.2)	45 (34.2)	5 (1.9)
Sweden	4 (7.7)	31 (40.3)	18 (18.6)	21 (14.9)	14 (7.7)	12 (10.7)

Source: Thomsen and Pedersen (1995).

It may be observed from the table that there are clear differences between countries in ownership structure, and hence in corporate governance. Notable among the principal characteristics of the 12 European countries are the following:

- a) Dispersed ownership is predominant in England (61 companies, representing 59.6% of the revenue of the 100 largest companies), and to a lesser degree, in Holland (23 companies, representing 47.4% of total revenues). France, Finland and Denmark also show a relatively high occurrence of this kind of ownership, but there are also countries where it is non-existent among the 100 largest companies, such as Italy and Austria.
- b) State ownership among the 100 largest companies is significant in Italy (29 companies, representing 37.9% of total revenues), Norway (13 companies representing 39.1% of revenues, France (22 companies representing 36.4% of revenues), as well as Spain and Finland (where public sector companies account for some 27% of total revenues). In England,

Holland and Belgium, on the other hand, state ownership is insignificant, representing less than 10% of the total revenues of the 100 largest companies.

- c) Foreign ownership of the 100 largest companies in the 12 European countries under analysis is high in Belgium, where 61 companies account for 46.7% of total revenues, as well as in Spain (45 companies, representing 34.2% of revenues), and Austria (38 companies, representing 33.5% of revenues). According to Kose (1997), cited in Prowse (1995), in the United States and Japan, both economies with a large domestic market, foreign ownership accounts for 5.4% and 4% of revenues respectively, while in France, the 16 foreign companies among the largest 100 account for less than 10% of revenues.
- d) Dominant minority ownership is a relatively prevalent form of ownership in various European countries such as Sweden (31 companies accounting for 40.3% of revenues), Germany (30 companies accounting for 40.5% of revenues), and France (28 companies accounting for 25% of revenues), with this form also significant in Italy, Finland and Belgium, but not, on the other hand, in England and Denmark.
- e) Among the 100 largest companies in each European country, family ownership is most significant in Denmark (30 companies, accounting for 30.1% of revenues), Norway (29 companies accounting for 15.2% of revenues), Germany (26 companies accounting for 17.3% of revenues) and Italy (20 companies, representing 16.7% of revenues). This form of ownership is nevertheless limited in England, Belgium and Spain (where it accounts for less than 10% of both numbers of companies and revenues).
- f) While cooperative ownership is extremely limited in extent in the majority of European countries analyzed, it is nevertheless significant in Denmark (17 companies, representing 19.9% of revenues), and in Norway (19 companies, representing 8.8% of revenues).
- g) The differences in ownership structure between European countries are related to a 'political theory of ownership'. A number of authors highlight the importance of regulation of financial institutions [La Porta *et al.* (1997)], the legal system, the historical evolution of dependence and the complimentary nature of institutions [Thomsen and Pedersen (1997), cited in North (1990)].

Ownership structures thus vary between countries as a result of various factors, such as the form of political regimes, legal systems, capital market structure, the historical experience of industrialization, geographical conditions and culture. These differing historical-institutional processes then result in the introduction of different forms of corporate governance. The task, from an economic viewpoint, is to evaluate the impact of different ownership structures on economic performance.

Econometric tests carried out by Thomsen and Pedersen (1997) did not show a statistically significant correlation between the two. That is to say, the form of ownership is not a variable that explains economic performance. On the other hand, a significant correlation was found between the form of ownership and the country, as well as the size of company. With regard to industrial sectors, the results obtained by these authors pointed to a positive but insignificant correlation.

Thomsen and Pedersen (1997) also attempted to determine whether patterns of ownership of large companies differ not only from country to country, but also by size and industry. Evidently, the form of ownership in each sector will vary from country to country so as to make generalizations of predominant forms of ownership difficult. The paper and pulp, cement and steel industries, for example, show a predominance of the 'dominant minority' form of ownership, while the textile and food industries are

generally controlled by families. In the telecommunications sector, for example, there is a trend towards a reduction in state ownership.

The authors observed that, in general, ownership structures vary within industries due to differences in transaction costs. For example, the predominance of cooperatives in rural areas is a reflection of the low cost of collective decision making, due to the convergence of aims and the existence of a common knowledge base. The high degree of government presence in a number of industries is associated with the high costs of forming contracts with the private sector, due to external factors and distortions resulting from the private appropriation of benefits. One of the problems faced in such sectors is that of the ‘free riders’, that is to say, agents that benefit from public assets without bearing the costs of their implementation.

With regard to company size and ownership structure, the authors observed that as a company grows, its stockholding control is less likely to remain in the hands of families, both because the managers are financially incapable of bearing the risks of ownership, and because they lack the knowledge and/or ability to manage the company. This tends to result in a separation between ownership and administrative control.

4. Changes in Corporate Control in Brazil in the 1990s

Taking as a reference the categories of corporate ownership presented in the preceding section, we sought to classify the 100 largest non-financial companies in the Brazilian economy on the basis of net operating revenue, considering not only 1990 (the base year for Thomsen and Pedersen) but also 1995 and 1997. In analyzing data for these three years, we aimed, in addition to forming a database that allowed comparison between such Brazilian companies and their counterparts in developed countries, to observe the pace of change of corporate control during a period of structural transformation in the domestic economy. Table 7 provides details of the results obtained, while Graphs 1 and 2 show the proportion of total revenues for the 100 largest non-financial corporations within Brazil in 1990 and 1997 by each category of corporate ownership.

Table 5
Ownership of the 100 Largest Non-Financial Companies in Brazil – 1990, 1995 and 1997)
(Percentage of Cumulative Revenues for the 100 Largest Companies in Brackets)

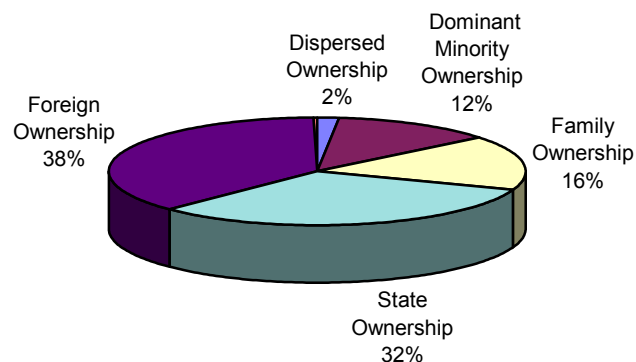
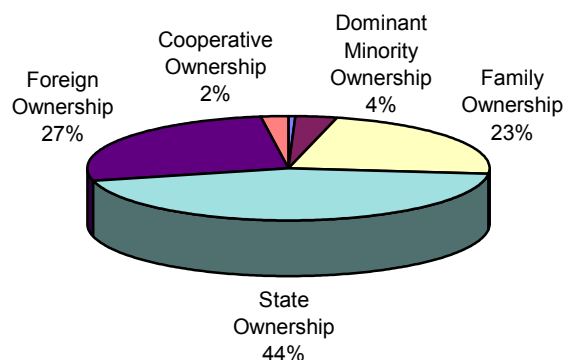
	Dispersed Ownership	Dominant Minority Ownership	Family Ownership	State Ownership	Foreign Ownership	Cooperative Ownership
1990	1 (0.4)	5 (3.5)	27 (22.6)	38 (44.3)	27 (26.9)	2 (2.3)
1995	3 (2.1)	12 (7.9)	26 (17.1)	26 (32.8)	31 (37.9)	2 (2.1)
1997	3 (1.8)	19 (12.4)	23 (16.5)	21 (31.8)	33 (37.2)	1 (0.4)

NB: For each year, the 100 largest non-financial companies were compiled using data from the *Gazeta Mercantil* (Balauço Anual 1991, 1996 e 1997). The classification of companies by category of ownership was carried out by the Planning department of the BNDES, with the support of the Credit Department. 1997 data considers revenues reported for 1996 and the stockholding structure in November 1997.

Source: *Gazeta Mercantil* (Balauço Anual 1990, 1995 e 1997). Compilation: BNDES/Planning Department.

Graph 1
Revenues of the 100 Largest Non-Financial Brazilian Companies by Category of Corporate Control - 1990

Graph 2
Revenues of the 100 Largest Non-Financial Brazilian Companies by Category of Corporate Control – 1997



Source: BNDES/Planning Department.

Over the period 1990-97, there were significant transformations in the structure of ownership of the 100 largest non-financial companies in Brazil. Most notable among these were:

- a) A 45% reduction in the number of state companies, which fell from 38 to 21, due to the process of privatization that took place during the period. Control of companies active in a variety of sectors, including steel, mining, rail freight and petrochemicals, passed to the private sector, with asset transfers over the period 1991-97 amounting to US\$ 37.6 billion. It should nevertheless be observed that state-owned companies' share of the revenues of the 100 largest non-financial companies fell less sharply over the same period, from 44% to 32% of the total. This is a reflection of the fact that the largest companies under state ownership, such as Furnas, Eletrobrás, Petrobrás and BR Distribuidora, all of which are active in the areas of energy/oil, have not yet been privatized.
- b) Since the privatization process is set to continue, it is likely that the number of state-owned companies among the 100 largest will fall even further over the next two years, with an estimated 15 of the 21 state-owned companies included in the 1997 list likely to be privatized. It follows from this that the transformations in the ownership structure of the 100 largest companies will be even more profound in the future.
- c) The *dominant minority category* of ownership has grown significantly from a mere 5 companies in 1990 to 19 in 1997. This reflects the fact that the vast majority of privatized companies have come under private control that has been shared between pension funds, domestic companies and foreign investors. The proportion of total revenues of the 100 largest companies accounted for by this category tripled over the same period to 12% in 1997. In addition to representing a new form of corporate control among larger Brazilian companies, the category (dominant minority control) should grow even further, since it is the standard form of control to emerge from the privatization process. Questions of corporate governance are particularly relevant to this form of ownership, which is separated from management control.
- d) In 1990, the foreign ownership and family ownership categories both included 27 of the 100 largest companies, corresponding to 26% and 23% of aggregate revenues respectively. Over the period 1990-97, this situation underwent a profound change, with foreign capital owning 33 of the 100 largest companies in 1997, and accounting for 37% of total revenues, while domestic families owned only 23

companies, which accounted for 16% of total revenues. It may therefore be observed that there was a significant advance in the presence of foreign companies from a wide range of countries among the largest companies in the Brazilian economy, while the share of total revenues represented by domestic family-owned companies fell by 7 percentage points over the same period. While this fall in proportional revenues was significant, it should be remembered that family-owned companies are still a dominant feature of the Brazilian economy. It is nevertheless important to evaluate the capacity for survival of the largest such companies in what is now a fiercely competitive business environment.

- e) It may also be observed that dispersed and cooperative categories of ownership were not significant forms of corporate governance within Brazil either in 1990 or in 1997. Having said this, the data show a moderate tendency for dispersed ownership to increase and for cooperative ownership to decline. It should nevertheless be noted that the 3 companies classified as dispersed in 1997 did not correspond to the Anglo-Saxon definition of the term, that is, with a large degree of fragmentation of control, and were merely identified as such since no single stockholder held more than 20% of the companies in question.

In comparing Brazil with developed countries, the following points are of note:

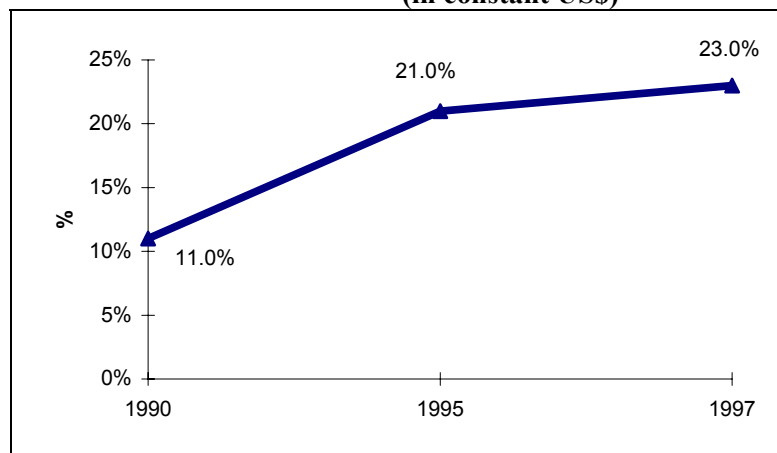
- a) The application of the classification methodology of Section 3 leads to the conclusion that the pattern of corporate ownership among the 100 largest Brazilian companies did not resemble any of the 12 European countries or the United States or Japan, either in 1990 or 1997. Having said this, there were some similarities of structure with Italy, with the exception of the relative importance of foreign investors (13.5% of total revenues in Italy against 26.9% in Brazil).
- b) With regard to the extent of foreign ownership, it may be observed that Brazil (27 companies accounting for 26% of revenues) already had a high foreign presence in 1990, relative to the European countries, as well as to the United States and Japan. With the increase in the share of foreign ownership between 1990 and 1997, the internationalization of the Brazilian economy became even more pronounced, with only Belgium having more foreign-owned companies among its 100 largest in 1997. Spain and Austria also showed high levels of foreign ownership among their largest companies. The strong foreign presence among the largest companies in Brazil is nevertheless worth highlighting, and is in contrast to developed countries such as the United States and Japan, where foreign companies represent less than 10% of the total.
- c) With regard to family-owned companies, it may be observed that in 1990, only Denmark and Norway had a higher number of such companies (30 and 29 respectively) than Brazil (27). In terms of revenues, on the other hand, Brazil accounted for 23% of the total in 1990, a figure exceeded only by Denmark (30.1%). Taking into consideration the reduction in the number of family-owned firms in Brazil between 1990 and 1997, its position at the end of this period is seen to resemble that of countries such as Italy, Germany, Austria, Sweden and Norway in 1990, with a share of revenue (16%) slightly higher than the European average (13%). The proportion of the 100 largest companies in Brazil represented by family-owned firms was nevertheless almost eight and five times higher than in Japan and the United States respectively.
- d) In 1990, Brazil had the highest proportion of state-owned companies among its 100 largest non-financial corporations, both in terms of numbers (38) and share of total revenues (44%). Notable among European countries was Italy (29 companies, representing 37.9% of revenues), France (22 companies, representing 36.4% of revenues) and Norway (only 13

companies, but which represented 39.1% of revenues). State-owned companies were also prominent in Austria, Finland and Spain. The corresponding figures for Brazil in 1997 (21 companies representing 32% of revenues) were nevertheless on a par with the 1990 figures for Austria (20 companies, representing 33.9% of revenues) and France (22 companies, representing 36.4% of revenues). It is worth noting that the ongoing privatization process in Brazil could reduce the number of state-owned companies among the 100 largest to only six within the next two years, since the government has proposed to sell some 15 companies in the electrical and telecommunications sectors. In this way, it is expected that the proportion of the 100 largest companies represented by state-owned companies will reach the same levels as those registered in 1990 for developed countries such as Holland (seven companies) and Belgium (six companies).

- e) While the category of companies under dispersed ownership is the prevalent one in England, the United States and Holland, Brazil is in line with several European countries where such companies are relatively rare, such as Austria (none), Italy (none), Spain (6), Sweden (4), Belgium (4) and Norway (6). In terms of revenues, such companies account for less than 10% of cumulative revenues for the 100 largest non-financial companies. While the share represented by such companies within Brazil has grown, it still remains low.
- f) If the 100 largest non-financial companies in Brazil are classified into 32 business categories (both industrial and service), it may be observed that in only six of these is the dominant category of ownership the same as it is in the 12 European countries. These include sectors where there is a predominance of state-ownership predominates (oil and gas production, electricity and telecommunications), foreign ownership (automobiles and gasoline retailing), and family ownership (department stores).

Another inference that may be drawn by introducing new variables into the same data sets, regards the concentration of the Brazilian economy as a whole. If the cumulative revenues of the 100 largest companies measured in constant US\$ is expressed as a percentage of GDP for the same year, then the percentage more than doubles over the period 1990-97, as is demonstrated in Graph 3.

Graph 3
Net Operating Revenues of the 100 Largest Non-Financial
Companies in Brazil as a % of GDP
(in constant US\$)

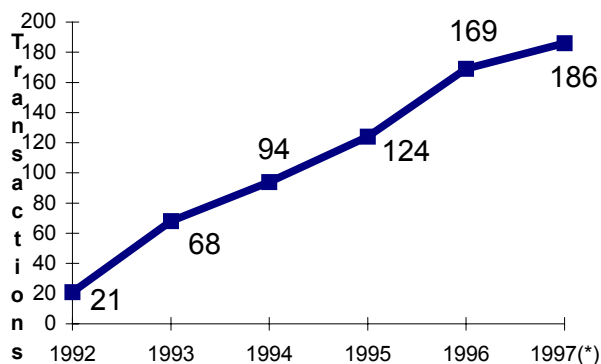


Source: BNDES, AP/DEPPO

In this way, there has been, in addition to the growth in share of companies under foreign and dispersed ownership, a growth in the share of the economy represented by the 100 largest companies that has paralleled the transformations in corporate control over the period 1990-97. Since GDP is measured in aggregate terms, this kind of ratio can be regarded as a proxy for, or better, an indicator of a tendency towards concentration, rather than a direct measure of concentration itself.

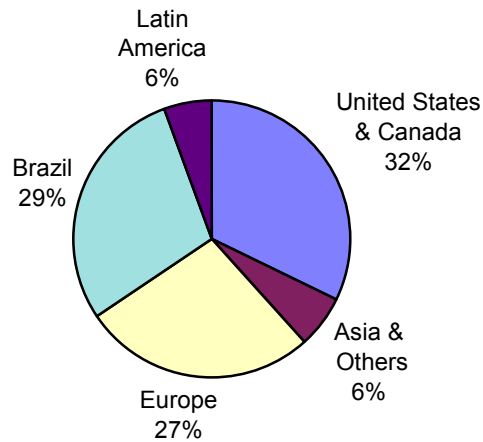
Graphs 4 and 5 show the development of mergers, acquisitions and investments among companies of various nationalities within the Brazilian economy for the period 1992-97. During the period in question, there were some 600 operations of this type, with acquisitions or associations by Brazilian companies accounting for 29% of these. In addition to the rapid evolution of such operations in recent years, mention should be made of the notable role played by North American companies, which accounted for the majority of mergers, acquisitions and associations. This data is a further element that corroborates the profound transformations in the nature of corporate ownership that have occurred in Brazil during the 1990s, as can be seen from Table 5.

Graph 4
Mergers, Acquisitions and Associations between Companies of Different Nationalities within Brazil, by Annual Number of Transactions - 1992/97



Source: KPMG Consulting, as quoted in the *Folha de S. Paulo* (01.11.97).

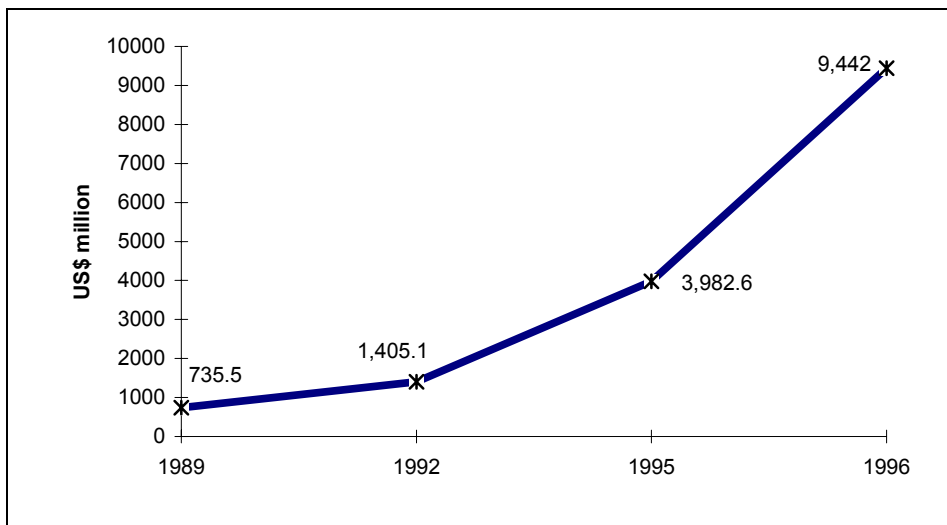
Graph 5
Mergers, Acquisitions and Associations between Companies of Different Nationalities within Brazil by Country of Origin - 1992/97



Source: KPMG Consulting, as quoted in the *Folha de S. Paulo* (01.11.97).

Finally, it should be remembered that these transformations in corporate ownership took place in a macroeconomic context characterized by a resumption in direct investment in the Brazilian economy, amounting to US\$ 9.4 billion in 1996. Without doubt, a significant portion of this amount was used in the acquisition of companies, either of outright control, or of shared control (Graph 6).

Graph 6
Foreign Direct Investment in Brazil - 1989-96
(US\$ million)



Source: Banco Central.

There is thus evidence of formation (or rather expansion) of certain categories of ownership structure at the expense of others, which is apparent both from the levels of foreign direct investment, the number of mergers and acquisitions and the results of evaluating changes in corporate ownership among the 100 largest non-financial companies in Brazil. In the light of the

importance of such companies, it is important to follow such transformations carefully, principally with regard to their strategic effects on the development of the domestic economy.

5. Conclusions

Following the long expansion cycle that lasted until the start of the 1980s, and that was based on the classical 'three pillars' of state-owned, private Brazilian-owned and foreign-owned companies, Brazil sought other ways of activating a new cycle of economic growth. Structural transformation, opening to foreign trade, monetary stabilization and privatizations have all occurred during the 1990s, with important effects on the largest companies, including most notably, as this article has shown, changes in corporate control.

New forms of corporate governance, especially shared stockholding control, have become increasingly important within the Brazilian economy, tripling their share of the cumulative revenues of the 100 largest non-financial companies in Brazil to around 12% of the total, with this growth due in large part to the privatization process. Questions of corporate governance are particularly relevant to such companies, since as a result of the inevitable separation between ownership and management, the controlling stockholders have become responsible for designing new mechanisms of delegating to, providing incentives for and monitoring the activities of management. More importantly, contracts have been established with controlling stockholders that, to a large degree, determine strategic issues. In such cases, the identity of the controllers, the nature of ownership and the company's strategic objectives become key determinants of its performance.

In addition to the growth in companies with shared ownership, there are two notable tendencies observable in changes in control among the 100 largest non-financial Brazilian companies, namely the increase in foreign ownership and the relative reduction in ownership by domestic families.

With regard to foreign capital, a variety of evidence is available, such as the growth in direct foreign investment, as well as in the number of mergers and acquisitions, that points to the increasing importance of such investors. When the Copenhagen Business School methodology was used to analyze changes in corporate control, it was found that the share of cumulative revenues of the 100 largest non-financial Brazilian companies represented by foreign-owned companies had increased from 27% to 38% over the period 1990-97. This observation suggests that the Brazilian economy is one of the key arenas where foreign companies of various countries confront each other or form strategic alliances in search of global market share. Some of these companies are concentrating on winning a share of the domestic market, including Mercosul, without necessarily generating a surplus for export, while there are other foreign groups that are seeking to position themselves in sectors where the domestic economy offers distinct comparative and competitive advantages.

As a result, domestic family-owned companies are facing at least three kinds of pressure, even if there is a relatively robust core of such companies within the Brazilian economy, that have strong balance sheets and modern and professional management. In particular, they are under pressure to hand over the running of their companies to professional managers, as some companies have already done, as well as to form strategic alliances, since new technologies, financing and marketing mechanisms oblige them to form associations in order to strengthen their competitive positions. The greatest limitation nevertheless remains their capital structures and access to financing. The traditional view of the 'captain of industry' who still believes that 'if you don't own everything, you don't own anything' has proved inadequate in a context where risk capital

(equity) has become not only a less onerous form of financing, but also more suitable in terms of corporate governance, since it reduces the asymmetry in information between the providers of capital and the managers of a company.

There is thus a correspondence between structures of corporate governance and financial governance, which is a subject for further articles in this field. This paper merely attempted to present the 100 largest non-financial companies in terms of a methodology of ownership classification that allowed the evaluation of the transformations that they have undergone, as well as the drawing of international comparisons. These transformations in ownership structure show that the principal Brazilian companies are undergoing profound changes.

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