

# Large Companies in the 1990s: Strategic Responses to a Scenario of Change

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## Summary

The object of this paper is to analyze the transformations that have occurred in the largest companies of the Brazilian economy during the 1990s, based on an examination of ownership structure. Important strategic commitments are decided on the basis of corporate structures. In this way, we have evaluated two complementary and interrelated processes from a microeconomic point of view: mergers and acquisitions that occurred during the period 1991-98, as well as changes in corporate control of the 100 largest companies over the same period. In order to achieve this, we used concepts associated with the theory of corporate governance as a theoretical point of reference.

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## 1. Introduction

This paper analyzes the transformations that have occurred in the largest companies of the Brazilian economy during the 1990s on the basis of an examination of corporate control. Trends of a strategic nature within such companies are examined from a microeconomic point of view on the basis of two complementary and interrelated processes: mergers and acquisitions that occurred during the period 1991-98, as well as changes in corporate control of the 100 largest companies over the same period.

While the strategic responses have arisen on different planes, such as through the processes of internationalization, diversification and innovation, the analysis concentrates on the structure of ownership of the largest companies, taking into account the fact that this aspect determines important commitments of a strategic nature.

In the light of the difficulties of obtaining information on various merger and acquisitions transactions within the Brazilian economy, we used data compiled by KPMG, Porvenir Online and the BNDES. In addition, since the values of several transactions were not disclosed, we made several estimates, calculating the total volume of mergers and acquisitions that took place in Brazil during the period as US\$ 142 billion, including privatizations that accounted for 50% of this total. In this way, we also examined the implications of privatizations that took place during this period in various sectors of the economy, such as telecommunications, electricity and steel.

In a complementary manner, we examined the composition of corporate ownership of the 100 largest companies in the Brazilian economy for the years 1990, 1995, 1997 and 1998. On the basis of snapshots of the stockholder control for these years, we sought to infer the main changes that occurred in the ownership of companies. In particular, we examined the degree to which domestic family groups maintained or expanded their activities during a decade marked both by the withdrawal of the public sector, and the advance of new agents, such as institutional investors of both domestic and foreign origin. This approach used the classification of corporate control developed by professors at the Copenhagen Business School.

The scenario faced by the companies so analyzed during the 1990s was marked by structural changes in the Brazilian economy: trade liberalization, monetary stabilization and the privatization process mentioned above. In this way, the competitive and even the institutional environment that such companies were obliged to confront (companies that at the end of the 1980s occupied a salient position) underwent profound changes. The environment of stagnation and high inflation that characterized the 1980s continued into the early 1990s, although this was changed radically by new elements in this competitive environment, particularly from 1994 onwards.

Corporate strategy entails a basic question: the choice of the business area in which the company should operate. From this point of view the main concern is the long-term market position of the company in question, taking into account its internal resources.

Among the strategies adopted, the most significant are diversification and specialization. Diversification may occur through markets and/or technologies related to the current activities of the corporation, as well as through technologies that are unrelated to the capabilities that it has developed. The latter case is known as “conglomerate diversification”. Specialization may be understood as an attempt by a company to centralize its activities in a single core business. Diversification and specialization are thus antagonistic trends from a strategic point of view, since they define the boundaries of competition in different ways. Specialization attempts to concentrate on capabilities, as well as to centralize risk, while diversification attempts to reduce risk through greater or lesser synergies with the company’s current activities.

In addition to defining in which market companies should position themselves, what pattern of competition and which technological characteristics their respective products and technological processes should have, they must develop organizational structures in order to coordinate their activities and implement their strategies. To this end, companies constitute governance structures that define their vertical limits [Williamson (1985)]. On the basis of the attributes of the transactions that they coordinate, such companies develop assets, whether of a human, physical, geographical, temporal and/or dedicated nature with a high degree of specificity, that are capable of generating economies in their activities. In this way, companies develop capabilities that allow them to incorporate knowledge in an implicit way, thereby constituting complex organizational structures.

In general, strategic alliances are based on the development of specific assets. There are obvious examples such as a natural gas supplier that installs an industrial unit for a specific client, with dedicated assets in both a technical and geographical sense. There are also more subtle forms of this phenomenon, such as stockholder agreements with clauses governing withdrawal, the nomination of directors and investment criteria, that shape long-term alliances involving common business activities and interests.

In the case of Brazil, two aspects of the process of corporate change in the 1990s may be highlighted: the expansion of the pattern of corporate control on the basis of shared control between Brazilians and foreigners, and the formation of strategic alliances between domestic groups.

Taking into consideration these variables of a strategic and organizational nature, and starting from an examination of the market for Brazilian companies, understood as the privileged space for strategic actions, we will attempt, in the course of this paper, to record the salient characteristics of the configuration of the largest companies within the Brazilian economy. In the following section, we present estimates of mergers and acquisitions for the period 1991-98, the proportion represented by privatizations, as well as certain characteristics of this process, such as the most active sectors, the nationality of buyers and some inferences regarding the degree of concentration in certain subsectors. Taking as a reference the classification of corporate control presented by Thomsen and Pedersen (1997), we then examine the transformations in the 100 largest

companies of the Brazilian economy in terms of net operating revenue, independent of whether control is domestic, foreign or public sector. Finally, we attempt, by way of a conclusion, and on the basis of an overall vision of mergers and acquisitions and changes in the control of the 100 largest companies, to highlight the main transformations that have occurred among Brazilian companies during most of the 1990s.

## **2. Mergers and Acquisitions in Brazil (1991-98)**

Mergers and acquisitions refer to transactions carried out with a view to combining two or more companies into a single firm (merger) or acquiring an equity stake in an existing company, without this necessarily entailing its control through the ownership of all of its shares (acquisition). In this way, while the amounts of transactions relating to mergers and acquisitions may be distinct in nature, their joint evaluation allows us to obtain, for a given period and region, a *proxy* for the market in corporate assets, in which the goods are the companies themselves.

In defining their diversification and market positioning strategies, companies encounter trade-offs between transaction costs associated with mergers or acquisitions and the benefits arising from such strategies. The trend in mergers and acquisitions thus relates to the central question of economies in transaction costs, or what the limits to a firm should be, and to what degree a firm should internalize certain activities, increasing the range of transactions under its direct management, as opposed to accessing the products of such activities through market transactions.

The specificity of assets together with other attributes of transactions, such as the frequency of their realization and the associated degree of uncertainty, provides important indicators of the scope of the firm, according to the theory of transaction costs. At the same time, since this approach is inserted into the so-called new institutional economics, we must take account of the fact that corporate organizations (governance structures) also have their scope determined by the institutional environment.

For its part, the institutional environment has been significantly altered. The globalization process, to the degree that it has expanded markets through the removal of barriers to flows of goods, services and capital, has also altered the institutional environment in which companies are used to operating. In addition, it has led to fiercer competition between companies, not only within Brazil but also throughout the world. In this way, the evolution of mergers and acquisitions should be understood as a strategic response on the part of corporations to the emergence of this new institutional and competitive environment caused by the globalization process. The principal consequences of this evolution are the emergence of megacorporations, the concentration of production and the increase in minimum scales of operation in various sectors.

The most significant motivating factors behind this trend towards mergers and acquisitions are:

- The rapid penetration of new markets;
- The consolidation of market shares at global level;
- Investment opportunities as a result of the deregulation of markets;
- Changes in technological standards, leading to large-scale economies of scale in production and cost reductions;
- The creation of synergies of a technological, financial, market and organizational nature;
- The possibility of financial gains.

Since 1990, there has been significant growth in mergers and acquisitions at international level. Between 1994-98, transaction volumes grew at an average annual rate of 43%, reaching over US\$ 2 trillion at the end of the period.

Of the largest international mergers and acquisitions, a significant proportion involved U.S. corporations. The largest transaction, announced in November 1998 between Exxon and Mobil, amounted to US\$ 86.3 billion (sum of the market capitalizations of the two companies). There are other examples of large-scale transactions, such as the operation between Travelers Group and Citibank (US\$ 72 billion), between AT&T and TeleCom (US\$ 70 billion) and between BP and Amoco (US\$ 55 billion). At international level, a predominance of transactions in the financial, telecommunications and oil sectors may be observed.

Another aspect to consider is the relationship between the trend in mergers and acquisitions and foreign direct investment. According to the United Nations Conference on Trade and Development [Unctad (1998)], the same trend is the main factor that drives foreign direct investment flows. In 1997 alone, cross-border transactions involving companies of different nationalities represented 85% of foreign direct investment flows [Unctad (1998)], with these having grown at an annual average rate of 21% during the period 1987-90, 30.2% per year during 1991-95, and 45.2% per year during 1996-97.

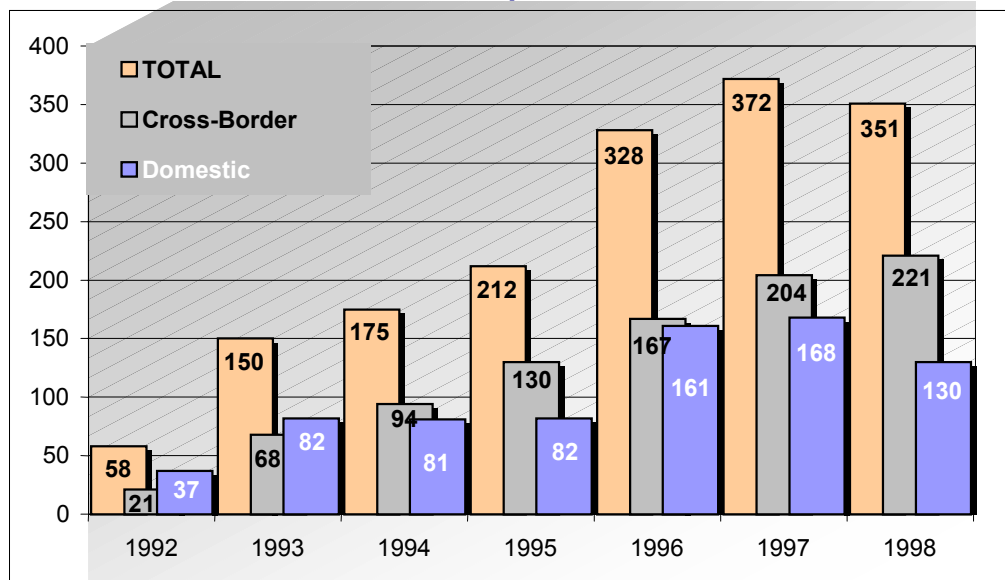
Within Brazil, the entry of foreign direct investment is also closely associated with the privatization process as well as the trend towards mergers and acquisitions. Investments in the acquisition of public sector companies amounted to US\$ 2.6 billion in 1996, doubling to US\$ 5.2 billion in 1997, and accounting for 28% of all investment in Brazil for these years [Laplace and Sarti (1999)]. Mergers and acquisitions, including the private sector, accounted for 30% of such inflows in 1995, and for 32.5% in 1996.

The relative shortage of information on genuine mergers and acquisitions in Brazil should nevertheless be emphasized. Graph 1 presents the development of these in terms of numbers of transactions during the period 1992-98. The total value of mergers and acquisitions in Brazil during the period 1991-98 was estimated at around US\$ 142 million, including privatizations, which accounted for 51.7% of this total. According to

KPMG (1998), in 1998 alone, these transactions represented a volume estimated at between US\$35-40 billion.

Graph 2 presents estimates of transaction volumes for mergers and acquisitions in Brazil by sector of activity, while Table 1 shows the number of transactions by sector. As may be observed from this graph, mergers and acquisitions in 4 sectors (electricity, telecommunications, financial and steel) accounted for some 60% of the total observed during the period. The privatization of state-owned companies in capital-intensive sectors explains the higher transaction values, although if we observe the number of transactions carried out, we see that the food, beverages and tobacco, financial, chemical and petrochemical sectors were the most dynamic.

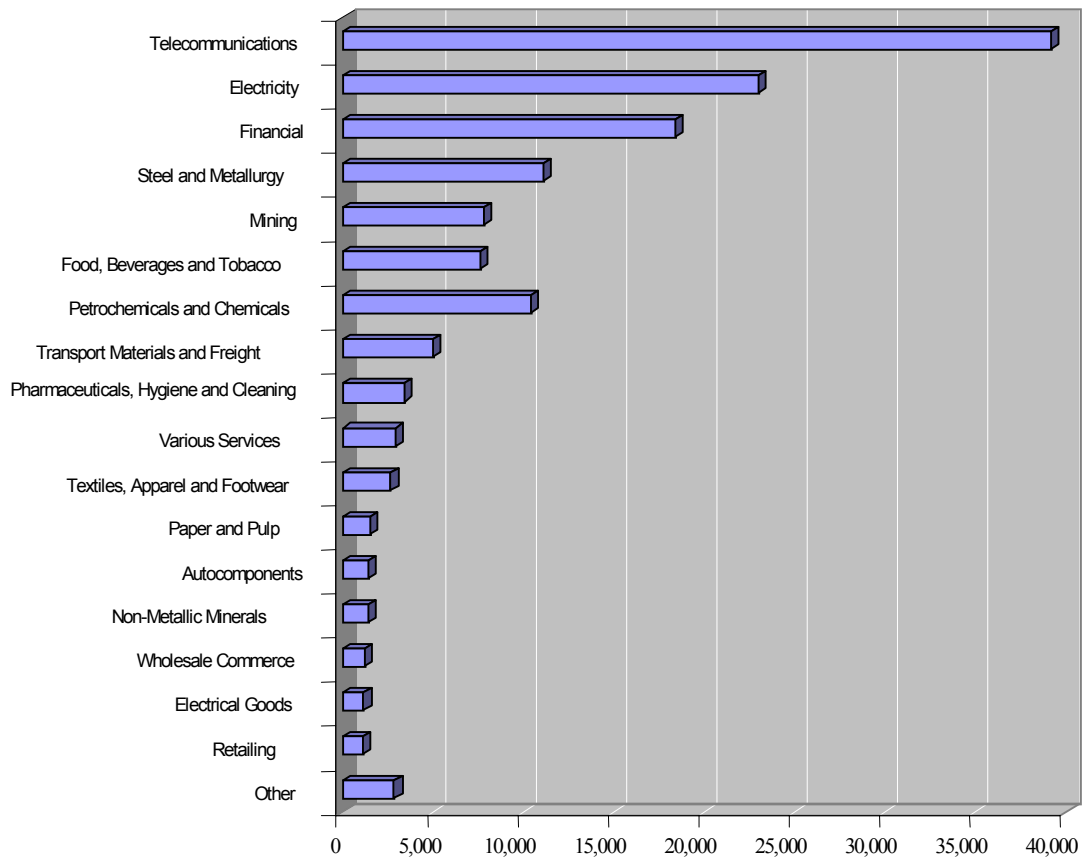
**Graph 1**



Source: KPMG.

**Graph 2**

Value of Merger and Acquisition Transactions between 1992-98, by Sector of Activity (US\$ billion)



**TABLE 1**

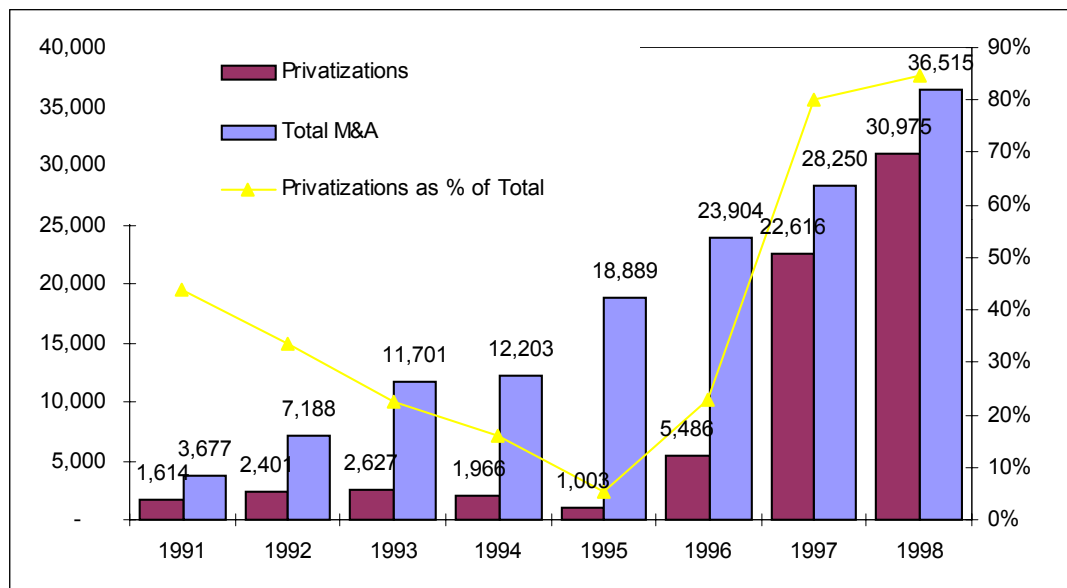
**Number of Merger and Acquisition Transactions carried out between 1992-98, by Sector of Activity**

Principal Sectors	1992	1993	1994	1995	1996	1997	1998	Total
Food, Beverages and Tobacco	12	28	21	24	38	49	36	208
Financial	4	8	15	20	31	36	28	142
Chemicals and Petrochemicals	4	18	14	13	18	22	25	114
Metallurgy and Steel	11	13	11	9	17	18	23	102
Electrical and Electronic Goods	2	7	5	14	15	19	9	71
Telecommunications	1	7	5	8	5	14	31	71
Other	24	69	104	124	204	209	193	938
<i>Total mergers</i>	<i>58</i>	<i>150</i>	<i>175</i>	<i>212</i>	<i>328</i>	<i>372</i>	<i>351</i>	<i>1.646</i>

Source: KPMG, in Favaret (1999).

The highest value transactions fall into the capital-intensive sectors. Since the privatizations in these sectors took off above all during the two-year period 1997-98, it may be observed that the share of all mergers and acquisitions represented by such sectors rose during these years, amounting to 80% of the corresponding total (Graph 3).

**Graph 3**  
**Share of Privatizations in Mergers and Acquisitions**



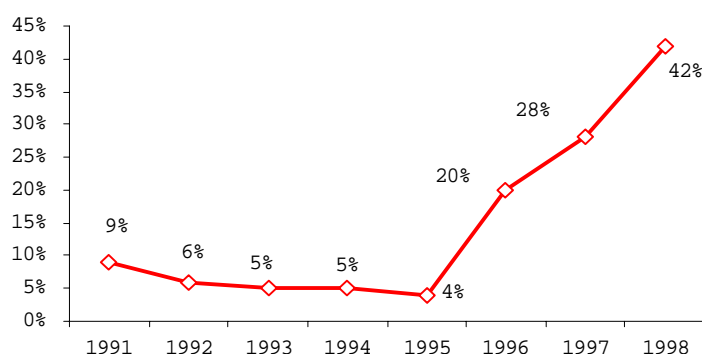
Source: Authors' estimates; for data on privatizations, the source is the BNDES

In terms of value, the telecommunications, energy and steel sectors predominate. It may also be seen that for most companies, the form of stockholder control shifted to a shared model, i.e. an arrangement that included both domestic and foreign partners. Also

of note is the presence of consortia of domestic stockholders, with a predominance of pension funds. Such issues will be discussed in the following sections.

Significant growth after 1995 in the share of foreign capital in privatized companies may be observed in Graph 4, rising from around 4% to 42% of all transactions carried out during the period 1991-98. Despite this growing participation of foreign companies in the privatization process, as well as in mergers and acquisitions as a whole, it should be emphasized that activity among domestic companies in this area has been far from timid. Such companies perceived that the privatization process and the foreign interest in privatized companies presented good opportunities for diversifying their activities, and formed alliances and partnerships between themselves and with foreign companies, through which they leveraged resources such as technology and know-how.

**Graph 4**  
**Foreign Participation in Privatizations - Total**  
**(Cumulative Values)**



As an example of a strategic alliance between domestic groups, we may cite the case of the Votorantim group that formed a consortium with the Camargo Correa group and Bradesco, VBC, in order to participate in privatizations in the electrical sector. In 1997, this consortium acquired control of CPFL, in conjunction with several pension funds, using this company to form an association with Electricidade de Portugal in order to buy Eletropaulo in 1998. We may also highlight the group's activities in the cement sector, where it acquired a series of smaller companies with a view to maintaining its leadership of the sector. The Camargo Correa group, for its part, formed partnerships with other heavy construction companies in order to manage highway concessions (Via Lagos e Ponte S.A.), and also took advantage of the trend in mergers and acquisitions to enter the cement market that represents a complementary activity to the group's core business (heavy construction).

Another example is the Inepar group, whose activities centered on the industrial assembly and electrical equipment sectors, of which the group increased its share through acquisitions, such as Sade Vigesa, which it merged with FEM (belonging to Companhia Siderúrgica Nacional – CSN) to create Inepar-FEM, the largest industrial

assembly company in Brazil. Inepar-FEM currently has a partnership with the German company, Noel Stahl that adds technology to freight transport within ports. In addition, the company has used other partnerships to diversify its activities, making advances in the electricity (operation of hydroelectric plants) and telecommunications sectors through opportunities offered by the privatization process. An example of this is the group's participation, together with Motorola (U.S.), Nissho Iwai and DDI (both Japan) and the Suzano group, in the Global Telecom consortium that won the concession for the Band B cellular telephony license for the states of Santa Catarina and Paraná.

These are not isolated cases, and arise from the performance of the Brazilian economy in recent years, which has created a favorable environment for the growth in share of foreign companies in privatizations as monetary stability has been consolidated. This trend, together with the more open stance of Brazilian business has led to the flowering of alliances such as those mentioned above.

We may also observe a trend in the 1990s within certain sectors, such as food, beverages and tobacco, as well as retailing, involving exclusively private mergers and acquisitions. Liberalization has evidently had an impact on the intensity of such trends in these sectors, albeit through a process that differed from that of the electricity, telecommunications, steel and petrochemicals sectors, where the restructuring through mergers and acquisitions began with the withdrawal of the state from such productive activities. The financial sector has also undergone substantial transformations as a result of deregulation. Let us thus observe the main characteristics of these changes in corporate control arising from mergers and acquisitions from a sector point of view.

There are sectors in which this trend entailed predominantly private transactions, without any external stimulus to the internal dynamics of the sector itself. Such sectors include food, beverages and tobacco; retailing; autocomponents; pharmaceuticals; automobiles; textiles and apparel; and cement, with no direct intervention by the state in the transactions in question. We will concentrate our analysis on the first two of these sectors, since these were highly dynamic (in terms of the number of transactions carried out) and are interrelated.

One of the factors that drove mergers and acquisitions in the food sector were downstream events in the retail sector, particularly in the super- and hypermarket segments. One of the statements we can make, therefore, is that mergers and acquisitions in the food, beverages and tobacco sector were a response by producers in search of greater bargaining power with their distributors, and vice-versa. These are related movements that to a certain degree are self-propelling.

It is clear that the trends in these two sectors also present peculiar characteristics. According to Faveret (1999), other driving factors may be identified in the food sector, such as the saturation of markets in developed countries that has led foreign companies to seek new markets; the increase in advertising costs (due to increased competition,

brands have become vital); concentration on principal businesses; and entry into regional and local markets.

Within the food, beverages and tobacco sector, transaction volumes have reflected the search for increased market power, most notably through diversification and activity in different segments. The main agents in this process have been foreign companies. According to Rodrigues (1999, p. 21):

“Foreign investment in these industries is taking the form of corporate mergers and acquisitions of companies, in an attempt to expand production/sales capacity, as well as to skip stages in the conquest of new markets. The acquisition of intangible assets, such as brands, and supplier/distributor networks, is a key factor in the growth of companies in such segments, where the dynamics of competition is driven by marketing strategies as a result of the increasing segmentation of consumption. Mergers and acquisitions are often more effective and preferable to organic growth in regional markets dominated by established brands.”

Of the 208 transactions that occurred within the sector between 1992-98, some 60% involved foreign companies as buyers. One of the consequences of this is that of the 20 largest companies in the sector in 1991, only two were foreign, while in 1998, the number of foreign companies among the 20 largest had increased to 13 [*Gazeta Mercantil* (1998)]. Despite this fact, as Rodrigues (1999) points out, Brazilian companies still predominate within the sector, with these concentrated in the meat and grain processing segments.

It is worth highlighting here the strategies adopted by Parmalat, Danone, Nabisco and Bunge y Born. The first three companies have adopted “specialized diversification strategies” [Faveret (1999)]. At the same time as these companies have diversified into subsectors such as pasta and biscuits, juices, teas and tomato derivatives, they have also maintained their principal activities in foods and beverages. Parmalat, for example, has acquired over 25 companies during the period, including Batávia, Mococa, Etti and Neugebauer.

Two other facts may be mentioned as having contributed to increased foreign investment in the sector within Brazil: the growth in food consumption due to the increase in purchasing power following monetary stability, and the growth in profit margins in certain segments with trade liberalization. According to Rodrigues (1999), countries where there is an unequal distribution of income, such as Brazil, have a high income elasticity of food demand, providing favorable prospects for the Brazilian markets. With regard to profit margins, the author also mentions the case of the beer segment, whose costs fell with the opening of the market and devaluation, since some of the raw materials used in the production of beer are imported (hops and colupolin/derivatives). Within this segment, the entry of

foreign competitors took the form of associations between foreign and domestic companies (Miller-Brahma and Anheuser-Busch<sup>1</sup>), on account of the lack of strong competition from imports.

In addition to the greater foreign presence, the mergers and acquisitions process led to an increased degree of concentration within the sector. In 1991, according to the classification of foods, beverages and tobacco in the “*Balanço Anual*” magazine, published by the Gazeta Mercantil (1998), the 20 largest in a sample of 338 companies accounted for 42% of the net operating revenue of the sector in 1998, while the largest 20 of a sample of 252 companies accounted for 67% of total revenues.

Mergers and acquisitions in the retail sector were also characterized by a search on the part of foreign companies for a greater share of the promising Brazilian market. The strategies of Carrefour and Sonae are notable here.

Carrefour, the domestic market leader, recently introduced acquisitions into its expansion strategy, purchasing the Eldorado chain and certain units of Lojas Americanas. The Portuguese Sonae group, which entered the domestic market in 1989, is currently the fifth largest supermarket chain in Brazil (according to the Gazeta Mercantil of May 11, 1999). This rapid growth was achieved through the incorporation of several chains, located most notably in the South Region, with Mercadorama, Coletão, Real, Extra Econômico, Nacional and Cândia the most important of these. Of the foreign companies operating within Brazil, only the U.S. group Wal-Mart has not yet adopted the strategy of expansion through mergers and acquisitions, having based its operations more on its capabilities in logistics and information technology.

Bompreço – a group whose activities are concentrated in the North East – is a case that deserves highlighting, having formed an association in 1996 with the Dutch group, Royal Ahold, by sharing its stockholding control. Since then, it has embarked on an aggressive acquisitions strategy with a view to strengthening its position, most notably in the markets of the North and North East, having purchased the Supermar and Petipreço supermarket chains.

We may note that such groups, in turning to mergers and acquisitions, have sought a larger share of regional markets as well as a larger scale of operation. Since Brazil is a large country, few retail groups have operations on a national scale. There is also a lack of observable diversification by groups into other retail segments beyond their traditional areas of activity through the acquisition of companies in different segments. What has occurred, particularly in the super- and hypermarket segment, is that companies have tried to diversify their supply of products, tending increasingly to sell apparel, medicines and other articles, even if this activity is not directly related to the trend towards mergers and acquisitions. In the strict sense of the word, this trend within the sector thus reflects specialization strategies (within their segments of operation) as an attempt to improve efficiency and increase market share.

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<sup>1</sup> These partnerships are currently being unwound after the announcement of a merger between Brahma and Antarctica.

In the case of privatizations, with mergers and acquisitions arising from public sector initiatives, we may highlight the electrical, telecommunications, petrochemicals and steel sectors. In the first two of these, this trend is recent, particularly within the electrical sector whose privatization has not yet been completed. In the other two sectors, the withdrawal of the state from productive activities has been followed by subsequent mergers and acquisitions.

In the electrical and telecommunications sectors, since the supply of these services was concentrated in the hands of the state, the privatization process led to a reduction in concentration and an increase in competition. Within the electrical sector, many companies were split up prior to auction, with each resulting company becoming responsible for a particular step of the process of supplying energy. This was the case of Cesp, which was divided into Elektro (transmission) and Cesp (generation). In addition, in order to avoid a trend towards verticalization after privatization, companies that are active at the generation stage may not buy other companies active in either transmission or distribution, and vice-versa.

The telecommunications companies were also restructured prior to their sale. For cellular telephony, holdings were created through mergers to operate in a given region (such as Tele Centro Sul). Groups that hold the control of a given cellular company may not control another company in the same segment, and may only participate in the control of a wireline company in another region not covered by the cellular company in which they hold a stake. In order to boost competition, B band operating concessions were sold in the case of cellular telephony, and mirror companies in the case of wireline and long-distance telephony.

Foreign companies were highly active in this process. Of all the companies privatized in the two sectors, foreign capital holds stakes in 60% of them, including cases in which foreigners control or share control with domestic companies or institutional investors. In general, foreign companies that acquired domestic electrical or telecommunications companies were already active in the sector in their countries of origin or in other countries. That is, they used the privatizations to expand their operations.

Domestic companies, on the other hand, sought to diversify their activities into privatized sectors, albeit in most cases without having any previous experience in these sectors. In this way, the formation of partnerships and the sharing of control have shown themselves to be the best alternatives for these companies, to the degree that they have been able to bring together knowledge, experience and resources.

Figure 1 presents the privatizations that occurred in the telecommunications sector in 1998. This table gives a good impression of the formation of consortia – partnerships between companies, and in particular, makes clear the role of Brazilian companies in these strategies. We would also draw attention to the active presence of institutional investors, notably pension funds. These issues will be discussed in greater detail in the

next section.

**Figure 1**  
Privatizations in the Telecommunications Sector – 1998

Company	Value (US\$ billion)	Acquirers (Share %)	Countries (Share %)
Telesp	4.97	Telefónica S.A and subsidiaries: 56.6 Telecom de Portugal: 23 Iberdrola Investimentos: 7 Banco Bilbao Viscaya: 7 RBS Participações: 6.4	Spain: 70.6 Portugal: 23 Brazil: 6.4
Tele Centro-Sul Participações S.A.	1.77	Timepart Part. Ltda: 62 Stet International: 19 Techold Part. S.A (Opportunity, Prev./Sistel): 19	Brazil: 81 Italy: 19
Tele Norte-Leste Participações S.A.	2.94	Construtura Andrade Gutierrez: 21.20 Inepar S.A Ind. e Const.: 20 Macal Inv. e Partic. S.A.: 20 Fiago Participações S.A (Funcef): 18.70 Brasilseg: 10.05 Cia. de Seguros Aliança: 10.05	Brazil: 100
Embratel Participações S.A.	2.27	MCI International: 100	United States: 100
Telesp Celular	3.08	Portelcom Participações (Portugal Telecom)	Portugal: 100
Tele Sudeste Celular Participações S.A.	1.16	Telefónica Internacional: 92.98 Iberdrola Investimentos: 6.98 NTT Mobile Communications: 0.02 Itochu Corporation : 0.02	Spain: 99.96 Japan: 0.04
Telemig Celular Participações S.A.	0.65	Telesystem International Wireless: 48 Opportunity: 21 Pension Funds (Previ and Sistel): 18 Others: 13	Canada: 48 Brazil: 52
Tele Celular Sul Participações S.A.	0.60	UGB Participações (Globopar and Bradesco) Bitel Participações (Stet Mobile Holding N.V.)	Brazil: 50 Italy: 50
Tele Nordeste Celular Participações S.A.	0.57	UGB Participações (Globopar/Bradesco) Bitel Participações (Stet Mobile Holding N.V.)	Brazil: 50 Italy: 50
Tele Leste Celular Participações S.A.	0.37	Iberdrola Energin S.A . Telefónica Internacional S.A. (Tisa)	Spain: 100
Tele Centro-Oeste Participações S.A.	0.38	Splice	Brazil: 100
Tele Norte Celular Participações S.A.	0.16	Telesystem International Wireless Inc.: 48 Opportunity: 21 Pension Funds (Sistel and Previ): 18 Others: 13	Canada: 48 Brazil: 52

Source: BNDES.

Within the steel sector, privatization was responsible for the main mergers and acquisitions. The Brazilian privatization process fits into a global trend towards private ownership within the sector that is linked to the need for restructuring (low margins, contraction in demand, excess production capacity), and that has tended to favor globalization of capital and concentration of production. We would therefore expect a trend towards consolidation, since the groups involved are domestic ones that are seeking a greater degree of competitiveness both within Brazil, and in the international market.

Within Brazil, the total of 102 transactions involving mergers and acquisitions in the steel and metallurgy sectors between 1992-98, led to an increased degree of concentration. While in 1991, the 20 largest of a sample of 533 companies accounted for 57% of the total net operating revenue for the sector, for a sample of 267 companies in 1997, the 20 largest accounted for 67%, according to the publication “*Balanço Annual*” [Gazeta Mercantil (1998)]. It is interesting to note that if mixed consortia are included, the share of total net operating revenue attributable to foreign companies rose from 36% in 1992 to 45% in 1997.

The privatization program was the starting point for the restructuring of the sector, which subsequently underwent other mergers and acquisitions, as was the case, for example, of Acesita. This company was purchased in 1993 by a consortium consisting of Nippon Steel; Companhia Vale do Rio Doce (CVRD); Bozano, Simonsen and the pension funds Previ and Valia. In 1996, Acesita, which already held control of Aços Villares, acquired a significant stake in CST (34%). In 1998, the French steel group, Usinor, in turn acquired a significant 40% stake in the company. The entry of Usinor into the Brazilian market was motivated by the possibility of expansion in the international market, taking advantage of the synergies between a stainless steel producer and the access to CST’s slab production, a strategic raw material for Usinor itself. Acesita in turn benefited through access to technology and the French company’s global distribution network.

Gerdau is another example of this process of mergers and acquisitions: it acquired Aços Finos Piratini in 1992, and merged its steel subsidiaries into a single company, Gerdau S.A. It also acquired a stake in Açominas, and has been internationalizing its operations with the creation of subsidiaries in Uruguay, Argentina, Chile and Canada.

According to Andrade et al. (1999), domestic companies have attempted to act in synergy with multinationals, through partnerships that establish best practices and technologies. An example of this is the joint venture, Cisa, between CSN and Imsa (Mexico) for the construction of a coated steel plant. Having said this, inflows of foreign capital may be considered as having been timid, and limited to minority stakes in several companies, such as Nippon Steel’s 18% stake in Usiminas, and Kawasaki’s 20% stake in CST. At the same time, the entry of Usinor into Acesita’s capital has undoubtedly helped to change this situation.

A characteristic of this trend towards mergers and acquisitions that deserves emphasis, is the role played by privately-owned banks in the privatization of the sector. Even at the start, in the cases of both Usiminas and CSN, these were active in forming consortia. At the same time, with the difficulties faced by the financial sector in the 1990s, together with strategic portfolio reallocations, there was a shift with the entry of new actors. This may be seen from the withdrawal of several banks such as Bamerindus; Bozano, Simonsen and Unibanco from the controlling stockholding groups of several sector companies. Such banks were drawn to the privatizations as a way of exchanging privatization currencies for real assets, but the need for investments with longer time

horizons subsequently led them to abandon the sector [Andrade et al. (1999)]. Camargo Correa is notable among the new agents for its presence within Usiminas.

Another highly relevant factor in the evolution of stockholding control of the Brazilian steel sector regards the privatization of CSN. Its auction was won by a consortium that included the Vicunha group whose activities had until then been limited to the textile sector, the bank Bamerindus, pension funds and other domestic banks and foreign investors.

With the privatization of CVRD in 1997, a case of circularity was created for a significant portion of the domestic steel industry, since CVRD holds equity stakes in various companies within the sector: Açominas (3% of voting capital), CST (21%), Usiminas (21%) and CSN (10%). The Consórcio Brasil consortium, composed of CSN (25.55%), pension funds (39.2%), Investvale and BNDESPAR (9.47%), Banco Opportunity (16.73%) and Nations Bank (8.97%) acquired Valepar, a holding company for 41.73% of CVRD's voting capital, for R\$ 3.33 billion. This privatization thus made a major contribution towards an increase in the number of cross-holdings within the sector, and reinforced the positions of CSN and several pension funds, notably Previ (the pension fund of the Banco do Brasil) to a major extent.

The restructuring process within the sector should continue to produce an even greater degree of concentration, both as a result of the complex corporate structure of the sector, and since possible redefinitions are already underway.

Within the petrochemical sector, the trend in mergers and acquisitions was also led by the privatization program. Sales of state holdings, unlike in the other sectors, began in the 1970s and intensified in the 1990s. Among the transactions carried out during the period 1991-98, the most notable were the sales of the raw material producers: Copene, Copesul and PQU. A total of 114 operations were carried out during the period, reflecting most notably strategies of consolidation and expansion, as was the case of the Suzano, Odebrecht, Unipar and Mariani groups.

The same groups competed fiercely for these raw materials complexes that are strategic for the production of the second-generation petrochemicals, in which these groups were concentrated. Some groups took advantage of the privatizations to diversify their activities into other subsectors, as was the case with Suzano. The group, which has traditionally been active in second-generation petrochemicals, also expanded into the production of synthetic rubbers, through the acquisition of Petroflex.

This sector was heavily affected by the process of economic opening that exposed vulnerable Brazilian companies to increased foreign competition, consisting of companies with greater economies of scale in production that were thus more efficient. The restructuring of the sector is thus still in progress, with a view to promoting economies of scale and greater competitiveness among the leading domestic companies. This restructuring process entails the redefinition of companies active within each

complex. That is, it is hoped that each group will concentrate its activities within a given complex and will sell its stakes in others to other companies. This restructuring process, which is of vital importance for domestic companies, is likely to cause new trends in mergers and acquisitions, with an increase in the degree of concentration.

A further issue that should be considered is the role of Petrobrás within the sector. The company has established partnerships with private groups, such as Odebrecht and Rio Polímeros, showing itself to be a highly sought after strategic partner among both domestic and international players in energy and petrochemicals.

The financial sector has been notable for mergers and acquisitions in the light of the liberalization of foreign ownership of the national financial system, and the deregulation of certain segments. Taking the share of total assets of the national banking system held by the 20 largest banks as a reference, it may be seen that foreign institutions made significant advances within the sector. While such companies accounted for less than 10% of assets in 1994, this figure had risen to 35% in 1998.

This advance on the part of foreign companies was largely achieved through mergers and acquisitions, a significant portion of which were carried out in conjunction with Proer, the program managed by the Central Bank to aid corporate changes within the banking system. Most notable among these transactions are the entry of HSBC through the purchase of Bamerindus; of ABN-Amro through the purchase of Banco Real; of Banco Bilbao Vizcaya through the purchase of Excel-Econômico; of Santander, through the purchases of Banco Noroeste and Geral do Comércio; and of Caixa Geral de Depósitos, through the purchase of Bandeirantes. In addition to the entry of new players, other foreign banks have used this opportunity to expand, such as First Boston (with the acquisition of Garantia) and Chase Manhattan (with the acquisition of Banco Patrimônio).

This movement was caused by the vulnerable situation of domestic banks following stabilization and economic opening. Domestic banks that were in relatively good condition also took advantage of a strategy of mergers and acquisitions to increase their scale of operations and to acquire complementary capabilities in various segments of the sector, in order to be able to confront an increasingly competitive environment.

Among domestic banks, we have the examples of the acquisitions of Banerj, Bemge and Banco Francês e Brasileiro by Itaú. The Itaúsa group, which includes Banco Itaú, is an example of a conglomerate that is active in the areas of sanitary ware, televisions and chemicals. At the same time, it has been observed that the group has attempted to concentrate on its strengths in the financial sector, since its participation in the wave of mergers and acquisitions, and even in the privatization process, has centered on the acquisition of financial institutions. Other examples of domestic banks that have sought to improve their position within the sector through acquisitions are Unibanco, with its purchase of Banco Nacional; Bozano, with its purchase of Banco Meridional; and Sudameris, with its acquisition of Banco América do Sul.

Bradesco's strategy deserves separate attention. The largest private bank in the country according to the publication "*Balanço Annual*" [Gazeta Mercantil (1998)], Bradesco has been diversifying its investment portfolio through the privatization program, acquiring, for example, stakes in electrical and telecommunications companies. In the financial sector, the bank has directed its efforts towards strengthening its position in various segments of the market, such as leasing, credit cards, pensions and insurance. To this end, it has incorporated a number of financial institutions, including Banco de Crédito Nacional (BCN), Indiana Financeira and Cia. de Seguros Geral.

The constitution by Bradesco of a portfolio of stakes in various companies is also significant. In many situations it has adopted a pro-active stance, from the point of view of facilitating various mergers and acquisitions. In the autocomponent sector, for example, it was instrumental in deciding the fate of Cofap and Metal Leve.

### **3. Changes in Corporate Control in the 1990s**

This process of mergers and acquisitions has been a strategic response by companies to an environment with a high degree of uncertainty and increased competition. The process itself has, for its part, redefined competitive conditions at global level, with the emergence of megacorporations whose asset base is in many cases larger than the GDP of several countries.

Within Brazil, the privatizations that took place between 1991-98 were responsible for more than half of all mergers and acquisitions. In addition, both privatizations and the award of concessions for new areas of the telecommunications sector (B Band), railroads, etc. formed a starting point for corporate restructuring in several sectors, driving mergers and acquisitions and the formation of partnerships between domestic and foreign companies.

We should not overlook the role of domestic capital in this process, both through the formation of consortia to participate in privatizations, and in smaller operations in various sectors.

In the case of Brazil, the correlation between mergers and acquisitions on the one hand, and concentration on the other, varies from sector to sector. Where the former kind of transaction has taken place spontaneously, that is without the direct interference of a regulatory agency, it has generally led to a spontaneous increase in the degree of concentration within a sector. By way of example, this may be observed in the food, beverages and tobacco, and retailing sectors. When mergers and acquisitions are subject, *a priori*, to regulation, as has been the case in the electrical and telecommunications sectors, these have not caused an increase in sector concentration, since the sectors were previously state monopolies that were already highly concentrated from the point of view of structure of property. Where privatization took place in deregulated sectors, it may be observed that these are still undergoing corporate restructuring, the end result of

which points to an increase in concentration. It may be affirmed that the transfer of fixed assets between domestic and foreign companies caused by mergers and acquisitions has redesigned the map of corporate control in various sectors of the Brazilian economy.

This section aims to analyze changes in corporate control on the basis of a sample of the 100 largest companies. It thus complements the analysis of mergers and acquisitions in the previous sector, since it deals with the same questions. While this analysis is restricted to a smaller sample, the companies in question are extremely important to the dynamics of the Brazilian economy on account of their size.

In the 1990s, we may observe the expansion of a new kind of control of large corporations in Brazil, namely *shared control*. In this form of control, no partner holds a majority in isolation, so that the management of the company necessarily depends on an agreement between the controlling stockholders. Shared control contracts cover various areas that are fundamental in defining the growth strategies adopted by the companies in question. In general, companies under shared control tend to have mainly institutional investors, both domestic and foreign.

An examination from this point of view of the transformations undergone by large companies depends on the recognition that the nature of property and the identity of the controllers affect corporate performance, since strategic positioning depends on the alignment of the interests between the contracting parties. Various theoretical instruments may be used to examine these questions in greater depth, including the theory of corporate governance, which is concerned with analyzing the mechanisms used in the control of firms.

Within the Brazilian economy, the state has, since the 1980s, and above all in the 1990s, redefined its role as a producer of goods and services by modifying its role in the control of the producing companies in question. Public sector companies that were active in the steel, paper and pulp, fertilizer, chemicals and petrochemicals, railroad transport and mining sectors, among others, underwent a change of control, implying a new definition of the state's priorities.

On the other hand, the domestic family-controlled company is under severe pressure, due both to its difficulties in establishing an adequate capital structure with a greater share of equity in the financing of its investments and to the inherent difficulties of an economy that is more highly exposed to foreign capital. In this situation, new agents have come to the fore as strategic articulators of the control of large domestic companies: institutional investors, particularly pension funds, and foreign investors. Strategic alliances have also been formed between domestic groups, establishing arrangements that involve the participation of such agents. These, then, are new forms of corporate governance in the Brazilian economy.

Corporate governance is related to the system of monitoring and incentives instituted to guarantee that managers manage companies in accordance with the interests of

stockholders. Developed countries have produced two stylized models of this: the Japanese-German model, in which the control of corporations takes the principal form of internal mechanisms consisting of cross-holdings, whether these are held by banks, insurers or even other companies; and the Anglo-Saxon model that is characterized by fragmentation of stockholding control, with an external control mechanism that is exercised through the capital markets [Lethbridge (1997)]. In the latter model, the prices of shares reflect the judgement of the market, regardless of how subjective this may be, in relation to the performance of managers and the companies they direct.

This debate becomes relevant upon attempting to associate corporate governance structures with competitive performance. The question for large domestic companies thus becomes that of defining which type of model to follow, given the institutional environment and the proximity to or distance from both the Anglo-Saxon and the Japanese-German models.

Even questions related to the degree of financial leverage are determined in the context of questions related to governance. This tuning of a financial nature is also a task for stockholders or even the banking system, through an analysis of risk.

In the perception of Thomsen and Pedersen (1997), the structure of property is one of the principal determinants of corporate governance. Some reasons for this are:

- The concentration of property on the part of large stockholders provides these with incentives to take an active role and an interest in the performance of the firm;
- The identity of owners is an indicator of their priorities;
- According to finance theory, stockholders and/or owners with diversified portfolios will not be averse to a higher risk profile for the company, while owners with a significant portion of their wealth in a single form will tend to propose low-risk corporate strategies;
- The liquidity of property will affect the time preferences of owners, and the investment behavior of corporations; and
- Integrated ownership structures (hierarchies) can reduce the costs of coordinating transactions with a high degree of specificity of assets [Williamson (1996)].

Thomsen and Pedersen (1995) present an analysis of corporate ownership in 12 European countries plus Japan and the United States, taking the 100 largest non-financial companies in each country as a benchmark, and classifying these in accordance with the system presented in Figure 2, which defines 6 categories of ownership.

**FIGURE 2**

## Categories of Ownership

Type	Concentration of Ownership
1. <b>Dispersed Ownership:</b> where no entity or individual possesses more than 20% of the voting capital.	<b>Low</b>
2. <b>Dominant Minority Ownership (Shared Control):</b> where a single owner, whether an individual, a family or a company holds between 20-50% of the voting capital.	<b>Medium</b>
3. <b>Family Ownership:</b> where an individual or family holds the majority (that is, more than 50%) of the voting capital. This category also includes foundations, since these reflect the personal desire of the founder to transfer a degree of control to the family.	<b>High</b>
4. <b>State Ownership:</b> where the government (local or national) holds the majority of the voting capital.	<b>High</b>
5. <b>Foreign Ownership:</b> where a foreign multinational holds the majority of the voting capital.	<b>High</b>
6. <b>Cooperatives:</b> where the company is registered as a cooperative or, in certain cases, the majority of the voting capital belongs to a group of cooperatives.	<b>Low</b>

The categories of property differ with regard to the degree of concentration of ownership and the origin of the capital (foreign, state, family, etc.). It should be noted that in the absence of any cross holding, all shares except those held by foreign investors are directly or indirectly held by families or nationals of the country in question. It is the form and degree of intermediation of ownership that differs from country to country.

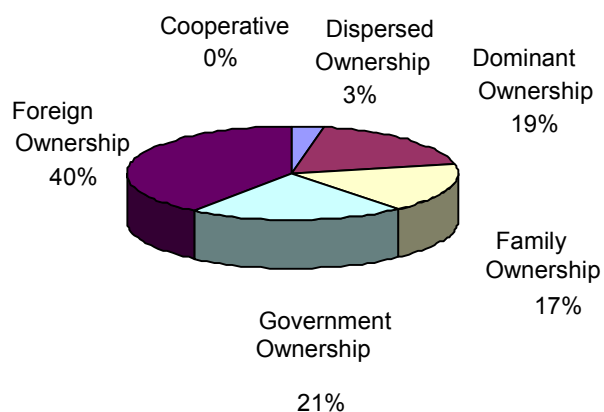
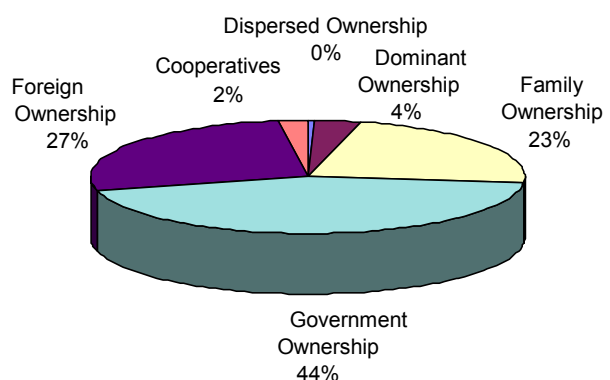
Considering the categories of company control presented in the previous section, we have attempted to classify the 100 largest non-financial companies in the Brazilian economy by net operating revenue for the years 1990, 1995, 1997 and 1998. In analyzing their positions for these years, we have attempted to evaluate the degree of dynamism of the changes in corporate control that have occurred in the economy during the larger part of the 1990s. Table 2 presents the results obtained, while Graphs 5 and 6 show for each kind of corporate control the share of the total revenue for the 100 largest non-financial companies in Brazil.

**TABLE 2**  
**Ownership of the 100 Largest Non-Financial Brazilian Companies**  
**(In Brackets, Percentage Shares of Total Revenues for the 100 Largest Companies)**

	Dispersed Ownership	Dominant Ownership	Family Ownership	Government Ownership	Foreign Ownership	Cooperatives
<b>1990</b>	1 (0)	5 (4)	27 (23)	38 (44)	27 (26)	2 (2)
<b>1995</b>	3 (2)	15 (11)	26 (17)	23 (30)	31 (38)	2 (2)
<b>1997</b>	3 (2)	19 (12)	23 (16)	21 (32)	33 (37)	1 (0)
<b>1998</b>	4 (3)	23 (19)	26 (17)	12 (21)	34 (40)	1 (0)

**Graph 5**  
**Percentage Share of Revenues for the 100 Largest Non-Financial Companies in Brazil, by Form of Corporate Ownership (1990)**

**Graph 6**  
**Percentage Share of Revenues for the 100 Largest Non-Financial Companies in Brazil, by Form of Corporate Ownership (1998)**



As may be verified, during the period 1990-98, the ownership structure of the 100 largest non-financial companies in the Brazilian economy underwent significant transformation. Among the facts resulting from these transformations, we may highlight the following:

- a) A reduction in the number of public sector companies, which fell from 38 to 12 of the 100 largest non-financial companies, due to the privatizations that occurred during the period. The government ceased to be the controlling stockholder of companies operating in a series of sectors, including steel, mining, railroad transport and petrochemicals. During the period 1991-98, asset transfers resulting from the sale of state-owned companies amounted to US\$ 68.3 billion. It is worth observing that in terms of the total revenue of the 100 largest non-financial companies, the share represented by such companies fell from 44% to 21% of the total. While the reduction was greater in terms of the number of companies, the above result was due to the fact that the large public sector companies such as Furnas, Eletrobrás, Petrobrás and BR Distribuidora, all of which are in the oil and electrical sectors, were not privatized.
- b) With the continuation of the privatization process, we would expect that there will be an even greater reduction in the number of public sector companies among the 100 largest over the next two years, since of the 12 remaining in 1998, an estimated 3 are due to be privatized, including Furnas.
- c) There has been significant growth of dominant minority ownership (so-called “shared control”), from only 5 companies in 1990 to 23 in 1998. It may be said that the vast majority of privatized companies came under shared control by a series of stockholders including pension funds, domestic companies and foreign investors. The share of the revenues of the 100 largest companies represented by this kind of control reached 19% of the total in 1998. This kind of ownership (dominant minority) that represents a new kind of corporate control among the largest Brazilian companies,

should grow further, since it is the model of control that has emerged from the privatization process. Questions of corporate governance are particularly relevant to this kind of ownership structure, in which there is a separation between property and control. It is worth pointing out that 50% of the companies identified as having shared control have foreign stockholders that own substantial stakes. This kind of association is known as “mixed shared control”, and entails the association of domestic and foreign capital.

- d) In 1990, among the 100 largest companies, 27 were under Brazilian family and 27 under foreign control, while in terms of revenues, the shares were 26% and 23% respectively. Both kinds of ownership underwent significant transformation during the period 1990-97, since foreigners came to own 34 of the 100 largest companies (40% of total revenues) against 26 companies owned by domestic family groups (17% of total revenues). We may thus observe that during the period under study, foreign companies from a variety of countries, expanded their presence among the largest companies in the Brazilian economy, while the share of total revenues represented by companies under family control fell by around 6 percentage points over the same period. While this fall in revenues was significant, we should not overlook the domestic family-owned company, since it is a characteristic feature of the Brazilian economy. We must nevertheless determine the capacity of such companies to survive among the largest companies in a highly competitive environment.
- e) We may also observe that the dispersed and cooperative forms of ownership were not and are still not significant forms of corporate governance among the largest Brazilian companies. At the same time, there has been a modest increase in dispersed ownership and a reduction in corporate ownership. It should be noted that the 4 companies classified as having dispersed ownership in 1998 were not such in the Anglo-Saxon sense, i.e. with highly fragmented control, with the cases analyzed classified as such since no single stockholder had a share of more than 20%.

In comparing Brazil with developed countries, we may make the following comments:

- a) In general, we may affirm, on the basis of the classification of corporate ownership, that with regard to the 100 largest companies, Brazil was unlike any of the 12 European countries, Japan or the United States, considering all categories of ownership. In relation to some of these categories, we nevertheless verified that Brazil has a similar structure to Italy, except for the fact that companies under foreign ownership account for a greater share of total revenue.
- b) We may observe that in 1990, Brazil had a relatively high proportion of companies under foreign ownership (27 companies accounting for 26% of revenues) with regard to the selected European countries, the United States and Japan. Since this share increased within Brazil between 1990 and 1998, the trend towards the internationalization of the largest companies has become even more accentuated. Among the other countries in

1990, only Belgium had a higher degree of internationalization among its 100 largest companies than Brazil did in 1998. Spain and Austria also showed high levels of foreign ownership among their largest companies. In any case, it is worth highlighting this high level of foreign ownership of the largest Brazilian companies with respect to developed countries. In the United States and Japan, for example, this percentage is less than 10%.

It should also be remembered that the transformations in corporate ownership among companies occurred against a macroeconomic background of a resumption in direct foreign investment in Brazil, which exceeded US\$ 20 billion in 1998. As already observed, a significant proportion of this investment was used to acquire companies, both through the purchase of full control, and through participation in a shared form of control.

#### **4. Conclusions**

On the basis of an examination of mergers and acquisitions, as well as of the changes that have occurred in the corporate control of the 100 largest Brazilian companies during the 1990s, which are complementary and interrelated processes, certain characteristics of this transformation are notable. There was, above all, a profound reconfiguration of the principal agents and the way in which these came to operate. The exit of the state from important productive sectors, such as steel, petrochemicals, railroads, electricity, etc., implied a new design for the classic “tripod” that sustained the development of Brazil until the 1980s, namely, private domestic capital, foreign capital and public sector capital. With the withdrawal of the last of these, the first two redefined their links. In this way, the privatization process was the starting point for trends in corporate and productive restructuring in a number of sectors.

It should be pointed out that the state did not withdraw from productive activity in all sectors. Petrobrás continues to play an important role in production, albeit having recently changed its operating model, forming partnerships with private Brazilian and foreign companies and becoming a strategic partner in certain sectors. The state also conducted and regulated the privatization of certain sectors such as telecommunications and electricity in such a way as to prevent the subsequent restructuring process from causing a concentration of production.

The increased share of foreign groups among the largest companies occurred largely as a result of mergers and acquisitions, as well as through their participation in several consortia, in both the electricity and telecommunications sectors. By maintaining this trend, Brazil will come to resemble Spain in so far as foreign companies will be present in the largest companies. This factor will definitively include the Brazilian economy in the expansion plans of multinationals from a wide range of countries and in a wide range of sectors. The clash in several markets between U.S. and European companies, whether in the retail, automobile and financial sectors among others, points to intense competition in these sectors. The externalities of this process, both in terms of benefits to consumers through lower prices, new product launches, greater concern with quality,

as well as through the incorporation of technology, may be positive. There is nevertheless a question as to whether the Brazilian market can maintain its attractions so that it is more attractive for foreign companies to reinvest their profits there than to remit them to their parent companies.

The expansion of shared control shows that strategic alliances are often established on the basis of stockholder agreements. These contracts define several vital aspects of corporate expansion strategies, such as the extent of areas of operation, funding mechanisms, degree of exposure to risks, technology and marketing policies, and outline the parameters that will define the behavior of managers. In this sense, it becomes extremely important to deepen the debate on corporate governance, since it remains to be seen whether the institutional model of corporate governance will be closer to an Anglo-Saxon or a Japanese-German one. In any case, the increase in the number of large companies in which there is a clear separation between ownership and management shows that it is necessary to develop practices and an institutional model that make this relationship efficient, so that strategies adopted may be implemented in an environment in which the degree of uncertainty is reduced.

Finally, although no less importantly, it is important to recognize the significant role that family groups occupy among the largest companies. International experience also provides examples of other countries with prominent family groups. During the 1990s, family groups within Brazil have been pressured from two directions: on the one hand, an increasingly competitive market resulting from commercial liberalization and exchange rate appreciation, and on the other, a high cost of capital in the domestic market. In this environment, less well-capitalized companies have been the objects of mergers or acquisitions by both foreign and domestic groups. At the same time, the family groups that remained well capitalized, such as the Votorantim and Gerdau groups, made strategic moves, both through diversification into new areas, and through the expansion of their markets through a larger foreign presence. Strategic alliances have also shown themselves to be an attractive route for groups that until the 1980s maintained the mentality of old captains of industry, according to whom “unless you own everything, you own nothing”. Some groups were successful in anticipating trends and adopted forward-looking strategies. Others adopted reactive strategies as responses to the environments they faced. In any case, domestic groups came to realize that the formation of partnerships, in so far as they joined forces, was a good strategy for responding to the new and changing global environment.

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