

IND 1603 - Gerência Financeira
Semestre: 2003.01
Profa. Mônica Barros

Dois artigos sobre Governança Corporativa.

Fonte: www.ibgc.irg.br

Why Governance Matters (setembro/outubro de 2002)

Alastair Ross Goobey - Especial para Newsletter do IBGC

Any investor who believed that governance was an irrelevance to their portfolios has had a rude awakening in the last twelve months. The Enron and WorldCom scandals in particular have created distrust in the largest stock market in the world. The fall-out for other markets has been significant. We have been witnessing the first post-World War II bear market caused, at least in part, by governance questions. History has precedents for such a market reaction. The Wall Street crash of 1929 was more severe because there was pyramiding of risk taking place in the 'investment trusts' where governance was lacking. Further back still, the South Sea Bubble in England in 1720, where the directors made share issues to themselves before selling into the boom, led to legislation that prevented new share issues for more than 100 years.

What are the lessons to be learned? The US has been governed by what Alan Greenspan has described as the 'CEO-dominant paradigm'. The power of the CEO in the US, who is also typically chairman of the board too, is very substantial, and some CEOs have not hesitated to use it, apparently in their own interests, rather than those of the shareholders. We should perhaps not be surprised that, having lionised the celebrity CEOs, some of them have behaved like kings of the jungle. Shareholders have to rely on well-informed and strictly independent directors to safeguard their interests on a daily basis. Only now are the US authorities requiring that Audit and Compensation committees are populated by clearly independent directors. While the long bull market was in place, those of us who had reservations about the US governance model were told that it clearly worked and needed no change. It illustrates that it is not the legal structure of governance that determines whether companies are run in the long-term interest of shareholders. It is the way the structures work in practice that is critical. It will not help if we now suffer from Schadenfreude at the discomfort in the US, because every country's system could probably do with improvement.

The whole essence of governance is to reduce the cost of capital to companies. If investors trust the boards to act in their long-term interests, they will demand a lower risk premium as against boards where shareholders seem to come last in the order of priorities. At its most extreme, poor governance closes the markets to companies entirely. The increased cost of capital as a consequence of recent events hits every company, almost across the globe.

The second thing that can be done is to increase the vigilance of shareholders, or at least their agents, the investment managers. As Mr. Greenspan has also commented, the US institutional investors have not seemed willing to intervene in companies where things seemed to be going wrong. This does not mean that investment managers need to micro-manage companies. What is needed is sufficient

monitoring so that, where there are serious questions to be answered about governance or performance, boards are contacted by shareholders demanding action. It is for boards to act, and if they refuse, ultimately they may need to be replaced by shareholders.

Until now, too little resource has been addressed by shareholders at this monitoring function. In some countries the major pools of money may be too closely linked with the corporations themselves, and executives may have discouraged action from their investment arms. Increasingly, however, the ultimate beneficiaries of insurance policies, pension funds or mutual funds, are demanding that their investment managers act where necessary. This should not be seen as a hostile act by company managements. There have been many cases where institutional support has helped see companies through difficult periods and press attacks. But it must be true that, in the end, it is the action of shareholders that will determine the future of every company. If shareholders do not execute this stewardship role, who will? The danger then is that, as we have seen, without this final sanction, there is no counterweight to the power of a strong executive with a compliant board of directors.

The International Corporate Governance Network, as its name implies, is trying to coordinate the activities of large investors from around the globe. The ideas that we promote are not fundamentally controversial. We were among those who helped the OECD draw up its own Code of Corporate Governance. We have recently agreed a Code of Best Practice for Executive Remuneration. It is not possible to legislate for every country, every culture, but there are some basic fundamentals that we promote: for example - transparency, without which no investor can make informed decisions; equal treatment for all shareholders; protection of minority rights; independent board members. These are just some of the basic principles of governance, but it is astonishing how their achievement varies between markets. This is, as we have seen recently, not just a case of developed markets against developing markets. Vigilance is needed in every market.

Brazil has made significant strides in recent years to address these issues. The Novo Mercado, with its higher standards of governance, has, I believe, been the only viable market for listing IPOs recently. If that understanding is correct, it illustrates more clearly than any other fact that good governance reduces the cost of capital, since lack of access to the capital markets increases the average cost of capital for companies enormously. It is clearly too soon to claim that higher governance standards will lead to better performance of the companies listed, but recent research in Italy has indicated some correlation in their own market between good governance and share performance.

This is the goal. The investment management firm I ran for nine years was drawn into more active involvement in corporate governance because it deliberately index-tracked much of its investment in developed markets. The only way in which we, as fiduciaries, could improve the returns to our clients was to increase the return on all companies through reducing overall risk. It is true that my firm went further than most investors will need to. We set up a family of funds that invest in companies where direct action by shareholders is needed to release the inherent value in the firms. This is a much more hands-on, interventionist role than most investors would want, or feel qualified, to play. It certainly requires different skills from those traditionally associated with fund management. As long as there are some investors prepared to take such action, and they draw in other, more passive investors, the system should work. Only where investors do not intervene at all, no matter how urgent the need, is the system likely to be deeply flawed.

*Alastair Ross Goobey – Reconhecido ativista em Governança Corporativa. Presidente dos Conselhos de Administração do Hermes Focus Funds, um dos maiores Fundos de Investimentos da Europa, membro do Conselho Consultivo Europeu do Morgan Stanley, membro do Private Sector

Advisory Group do Global Corporate Governance Forum – iniciativa conjunta entre o Banco Mundial e a OECD e Presidente do Conselho de Administração da ICGN – International Corporate Governance Network. Virá ao Brasil como convidado do IBGC – Instituto Brasileiro de Governança Corporativa como palestrante do 3º Congresso Brasileiro de Governança Corporativa que acontecerá dias 10 e 11 de Novembro em São Paulo. Maiores informações pelo telefone 11 3107 3101 ou pelo www.ibgc.org.br.

2nd IBGC Annual Conference, Sao Paulo, SP, Brazil (12/novembro/2001)
Robert Monks, norte-americano especialista em Governança Corporativa e autor de vários livros

There now exists a Global Capital Market. Large investment funds are available to finance ventures on every continent of the world so long as certain elements are present.

I use the image of a rocket and its design and energy components necessary for it to achieve "sustainable orbit" so as to illustrate the conclusion I have described in a recent book the New Global Investors. The Rocket is comprised of three distinctive parts - those that relate to the country in which a venture is domiciled - in green, those unique to the specific corporation- in blue, and finally the "nose cone" - the corporation itself- silver with a red star. The logarithmic scale on the left side shows the increase in values as the rocket achieves, first light off, then trajectory flight and finally frictionless orbit.

Investment by institutions is always made on a competitive basis. For investment in one country to be competitive with opportunities in another requires a comparable sense of security. Institutions are likely to "run for safety" - take their money out of risky places and bring it home. The language of security is highly individual. What will satisfy some people will not be acceptable to others. The concepts and words that I use in this presentation derive from my personal experience doing business in many countries on all the continents of the world.

The greatest enterprise starts with an individual. In the same way that a single "genius" like Pele can electrify the entire planet with his magic on the football pitch, so Thomas Edison, Edwin Land, Bill Gates have the unique commercial skills that have created huge value, vast employment and improved living standards for billions of people. No one has ever found any other basis for generative activity than the genius of the individual. Neither committees, institutions nor belief systems can create value of this kind. Until the so-called Protestant Reformation in the Seventeenth Century European World, this wealth generating energy was constrained by the belief that only the Church could own property. It is plain that investment competitiveness in some countries literally will not get off of the launching pad. This was the situation in the Communist world for half a century.

One of the predictable consequences of respect for individual genius is the creation of different levels of wealth within society. While this stratification may be acceptable for the rare genius, it is less tolerable with his descendants and followers - a class of unearned wealth. Societies are organized around the protection of property. In cases where ownership is concentrated too narrowly - or without perceived justification - societies tend to revolt. Human nature is susceptible of abuses. That is a given and will not change. The critical ingredient is the acceptance that certain people in performing what are considered to be societally useful activity will be rewarded more than those who do not. Concurrent with this principle is the tradition that property and power can exist outside of the governmental system. Blackwell records in the lengthy battles between kings and nobles and

merchants in early medieval England the importance of the grant of a charter to the City of London. Henceforth, no king would be permitted to withdraw the fundamental privileges that the City of London had been accorded. This was a continuing energy and a source of power not directly subject to royal control. Other European countries were loath to accord to commercial activity any such independence. Maybe this explains why the Anglophone countries early developed a more reliable tax base and avoided the social revolutions that decimated continental Europe during the nineteenth and early twentieth centuries.

Investors will inevitably be attracted by a domicile that traditionally respects the rights of property alongside the rights of changing government. Countries enjoying a viable economic trading system will be characterized by a beginning level of commercial ethics. It is virtually impossible to superimpose a successful global investment on to a society where the notions of fair play, truth telling and fairness are unknown, or, if known, are unpracticed. This certainly has been the situation in the former Soviet Union for the past dozen years.

It makes very little difference to an investor what rights exist in theory. What is critical is the practical capacity to enforce these rights at an affordable cost. In simplest terms - "does a rule of law exist?" Are there tribunals and are there judges who are institutionally invested in securing rights agreed by contract?

Consider the circumstances of Enron in India. Billions of dollars were invested in the construction of a take-or-pay oil fired power generating plant. Serious disagreements broke out between the company and the state of Mumbai, who was contractually obligated. In addition to the sales contract, the government of India, itself, had signed a guarantee of payment to Enron. Right now the plant is shut down, Enron is negotiating its sale, but at a price which will cover its costs - indicating world confidence in the guarantee of the Indian government. It will be hard for Mumbai to attract foreign investment without a guarantee.

One of the wisest observations about investing was made by a draftsman of the justly famous U.S. Securities Act of 1933. Reflect on the conditions prevailing at the time that act was passed. In brief, the entire commercial sector of the U.S. economy had collapsed and the leading practitioners had disgraced themselves. Depression ruled the land and the people had elected a new government to make change. Instead of installing a complicated system of government control over securities markets, the F.D. Roosevelt Administration contented itself with a regime based on full disclosure. "The purpose of this law is not to prevent a person from making a fool out of themselves, it is to prevent somebody else from making a fool out of them." Disclosure and truth are the keys.

In this same vein, countries can have laws that appear - usually in hindsight - to be unfavorable to investors. So long as the laws are publicly published, an investor cannot complain when those laws are applied against their interest. One situation that frequently occurs is multi class stock. One class typically is owned by the "insiders" and has virtual control over votes irrespective of the relative percentage of investment by the several layers of equity owners. If "informed" investors chose to acquire such neutered securities, it does not lie in their mouths to complain. On the other hand, if there are legal rights existing at the time of acquisition that are fundamentally changed by the organs of government enforcement, such would be an inhibition for involvement by Global Investors. Each country will have its own structure for monitoring the raising of capital and the enforcement of ownership rights. There is no "right" model. There is only a "right" informing theme - the sanctity of contract must be reasonably (from the perspectives of time and cost) enforceable.

In order better to understand value, we will work with a simple question - is it appropriate for a Global Investor to purchase common shares in Volkswagen? There are many kinds of shareholder, each with

distinctive interests that are not always compatible with the interests of the other investors. A Global Investor is typically the trustee of a pension plan with the simple obligation to collateralize the pension promise by maximizing the long-term value of trust assets. The beneficiaries of pension funds are not rich people. Fluctuations in market values are no longer primarily a question as to whether rich people are a bit richer or poorer, they are a question as to whether pensions will be paid to the roughly half of the population of the OECD world who have interests in employee benefit plans. This makes investment a matter of social and political concern.

Volkswagen has a widely known and respected brand name. Its design and product qualities are at the top of the automobile industry. Innovest, the Toronto based, strategic value advising firm concludes that Volkswagen will out-perform the industry. Its June 2001 rating is "Volkswagen received a rating of AA, ranking 3 out of 14 Automobile companies in this sector." This suggests that Volkswagen would be an attractive investment - but it is not the whole story.

The largest shareholder in Volkswagen is the Government of Lower Saxony with a little less than 20% (18.6%), which has been adequate to maintain control. Government officials have typically been on the Supervisory Board - Federal Chancellor Schroeder used to be Chairman, when he was the chief state officer- and it is clear that the company is run in large measure for the benefit of the state. Five out of its seven manufacturing plants are located there, notwithstanding a productivity of 46 cars per worker per year in contrast to 101 cars for the Japanese plants in northern England. Volkswagen stock is at approximately the same level -\$45/shares - as it was in 1997 even though it rose 40% in 2000 representing the effect of a \$2 billion stock buy back. Using conventional investment ratios, VW is valued by the market at about half the level of its competitors - 7-8 times projected 2002 earnings as against an average of 13-14 and Daimler Chrysler at 16. Volkswagen's market capitalization \$17.6 billion is 20% less than that of BMW although it has twice the revenue.

Volkswagen appears twice cursed from an investment point of view. Its earnings are reduced by needlessly high operating costs dictated by non commercial considerations and the multiple that the market applies to even these reduced earnings is drastically lower than the industry average representing lack of confidence that there is commitment to earnings growth. Lower Saxony as the controlling shareholder receives additional benefits of (i) subsidy of non-competitive wages and (ii) subsidized tax revenues, the subsidy being extracted from the other shareholders. Like many large companies, Volkswagen has been able to finance its operations from internal sources and is, as a practical, matter not subject to the cost of capital discipline of the market place. It would be interesting to know the extent to which the compensation of the principal officers of Volkswagen depends on the stock price.

How can a Global Investor justify acquiring Volkswagen common stock? In the short term, it is always possible to "buy low and sell high", but that is not a responsible investment policy for fiduciaries. A long-term investment decision would have to be based on the conclusion that the level of political and social harmony achieved through subsidies to Lower Saxony compares favorably to the costs of competitors in achieving comparable conditions in other locations. Otherwise, the holder of Volkswagen is faced with the prospect of never being able to generate free cash, either for distribution or reinvestment, at the level of others in the industry. The Global Investor must evaluate the extent to which attention to non-profit oriented values decreases the risk of continuing earnings and profits. When these values are unique to a major shareholder - like Lower Saxony in the case of Volkswagen - it would be difficult to conclude spillover benefits adequate to compensate the Global Investor.

Transparency is the key. As our rocket ascends towards orbit, it will become clear that the fullest possible disclosure of the impact of corporate functioning on society assures optimum valuation. The beginning point is the requirement of an independent audit. This was first legally required of publicly

owned companies in the United States in 1933. For much of the last seventy years, independent audits have been considered an unqualified good. Over the last dozen years, a number of cracks in this foundation can no longer be ignored. Many companies have relationships with audit firms involving a whole range of unrelated services, usually lumped together under the name of "consulting", where the fees dwarf those paid for audit. This creates an atmosphere of conflict of interest. In several recent scandalous situations in the United States, the audit firms' personnel and those of the company are interrelated to the point of incest. Waste Management constitutes one of the most egregious examples of audit abuse - every single financial officer of the company had previously been in the employ of Arthur Andersen, the independent auditor. The difference between form and substance here is very important - it is, frankly, extremely difficult to find board and audit committee members sufficiently skilled, motivated and persistent to deal adequately with the obvious problems of co-optation.

The information required to be disclosed in an Audit Statement by Generally Accepted Accounting Principles is far short of a comprehensive disclosure of the full impact of corporate functioning on society. Many items are difficult to describe in accounting language - intellectual property, trade marks, reputation, supplier relationships, employee skills - and there is a marked reluctance to require companies to disclose the costs they place on to society. These so-called "externalities" range from the physical emission of fluids and gasses that pollute the earth to the effects of plant closings on individuals and communities to the inherent problems caused by unsafe processes and products. There are beginnings in Europe, particularly in the United Kingdom, of comprehensive and consistent requirements for companies to disclose fully the "risks" inherent and probable in their operations. Ultimately, the objective is to provide potential investors with a full and complete informational basis for a decision to invest.

Many analysts all over the world conclude that the job of defining value is done by the public in placing value on the exchanges.. The "market" we are told will be the ultimate judge of value. It is assumed that the market knows all, evaluates all, takes all into account and produces a precise and unchallengeable value. While this is a very convenient formulation, we must pause to point out that it makes no sense. Consider the words of the great guru Peter Drucker.

"...and one of the basic problems is that management has no way to judge by what criteria outside shareholders value and appraise performance - the stock market is surely the least reliable judge or, at best, only one judge and one that is subject to so many other influences that it is practically impossible to disentangle what, of the stock market appraisal, reflects the company's performance and what reflects caprice, affects the whim of securities analysts, short-term fashions and the general level of the economy and of the market rather than the performance of a company itself."

All that we know is that conclusions need to be challenged; that there probably are no quantifiable answers and the only reliable value mechanism is constant test. We also know that "market" values have integrity only to the extent that full information is available to them.

Corporations acquire so much power that it is important to protect the institutions and values of a free society from being overwhelmed. An example of this from the United States is the success of the CEO organization, The Business Roundtable in 1994 in destroying the integrity of the accounting industry and shaming the United States Senate to declare that granting options to executives is not an expense. This is the device that enabled the Chief Executives of American companies over the last ten years to enrich themselves with compensation packages that would have been the envy of tyrants from times past. It is a commentary on the times that U.S. company values were not conspicuously bid down in the face of this obvious abuse. The abuse has a name - it is poor corporate governance.

Corporate governance has two distinct and important meanings. The first is the extent to which those who are engaged to run the enterprise are effectively accountable for performance to any informed and competence institution independent of their control. The temptation is that corporations are accountable only to themselves. Take Exxon for example. Here is a company that fouled the fisheries of the Pacific Northwest, that denies the existence of Global Warming and provokes boycott among European customers. To whom is Exxon accountable? The conventional wisdom is that Exxon is accountable to the market place. The argument is that the market will sell shares of any "rogue corporation" down to the point where its cost of capital is so high that it can no longer compete. What do you do with an Exxon that never has to go to the capital markets and, which, in fact, buys back billions of dollars of its own stock every year? This is not because Exxon is such a well-managed company - it is because the price structure of the oil business reflects its inability to reinvest its profits within the venture to advantage. Exxon is an extreme case. It is possible for shareholders acting together to hold most other companies to an acceptable level of accountability.

Beyond this, what of the corporation as a citizen. The first requirement is disclosure . In particular the law makers are entitled to have full information when they -uniquely empowered by popular vote - make determinations as to what are the appropriate boundaries of corporate behavior. No government can make sensible laws if it does not have full information. Providing this should be a requirement for corporate chartering. Secondly, corporations must show restraint in dealing with government . As I have pointed out above, in the case of the United States examples abound of excesses of corporate power. What this leads to is a corporatist society in which wealth is unfairly allocated according to the capacity to dominate the rule makers and the enforcers. Corporations must mitigate the pollution of the public interest. So long as laws are enacted which reflect the full knowledge and uncoerced action of government, corporations can exist harmoniously with society so long as they obey the law. We must press for this result. Otherwise, the question always needs to be raised as to whether laws are fair, reasonable and reflective of the public interest. There is no good answer to this question.

We are now reaching lofty altitudes and close to optimal valuations of business enterprises. I have suggested in *New Global Investors* that the world is approaching the point where universal pension funds own significant - close to controlling interests - in all publicly held companies everywhere. When this eventuality occurs, the concept of externality disappears - the owners of literally everything, everywhere, forever have no interest in trying to transfer costs to others. They are the others and all they would accomplish is to transfer costs to themselves. At the point of recognizing the need to internalize the costs and to reflect those costs in the pricing of merchandise we have created a corporate enterprise that truly can exist on earth without friction - it has achieved the posture of sustainability. This must be the objective of us all.

When the values of corporations and society are in harmony, businesses will operate more efficiently and will deserve a higher valuation. Hopefully, this status will invite imitators and other companies will try to align their own functioning with societal interest.

I have attempted in these few minutes with this graphic presentation to give you some comprehensive insight into the way in which business and society relate. In particular, I have tried to point out what are the essential characteristics that a host country and a local management must bring to an enterprise in order to make it competitive. I am, frankly, hoping to start a contest - a race to the top - A world in which the energies of corporations can create wealth for all societies without unacceptable and unrecognized costs.