



## **“Growth, Financing and Corporate Governance”**

### **The Growth Process of Colombia’s Bavaria, a Company with Global Objectives**

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English translation of original Spanish version

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## **“Growth, Financing and Corporate Governance”**

### **The Growth Process of Bavaria, a Company with a Global Vocation**

*Value creation requires a business attitude that understands the importance of growth and access to efficient local or international sources of financing in order to consolidate a successful business process. The incorporation of good Corporate Governance practices is a fundamental key to gaining access to international financing and a prerequisite for value creation and business growth.*

One of the major challenges faced when discussing Corporate Governance is to show that decisions resulting from a good model of business governance contribute to the company's economic results. The case of Bavaria permits the identification of three basic variables responsible for its growth and business success: optimization of the original business; regional expansion through mergers and acquisitions; and access to local and international financing. The variables of expansion and financing are linked by a common decision: the incorporation of international Corporate Governance practices. The entry of the International Finance Corporation (IFC) as an investor contributed to the creation of value by providing support and advice to strengthen the standards of Corporate Governance within Bavaria.

It is an essential premise of Corporate Governance that each company must tackle its process individually; “one size does not fit everyone”. A process of incorporation of Corporate Governance practices must begin with the identification of the key variables in the decision-making processes, as well as the economic incentives for adopting them and the controls ensuring that they are effectively implemented.

The aim of this case study is to document a successful business process clearly illustrating the relationship between the Corporate Governance structure and the financing of growth and the success achieved by this company in its regional expansion. Bavaria is a good example of an integral process that highlights measures of particular importance for the Latin American market and for companies in the same sector in other regions.

Additionally, the object of this case study is to convey lessons learnt and the need to design, implement and administer the principles of Good Governance for an organization, respecting its culture, its economic environment, and a process that truly institutionalizes the principles of transparency, efficiency and accountability that characterize Good Governance.

### *Bavaria and its Context*

Bavaria S.A. is an outstanding flagship company within the Colombian economy, a front-rank player in Latin America and a strong competitor in the world brewery market. At the same time, it is a company closely linked with Colombia's cultural and social heritage. Bavaria has contributed to the development of the country's economy, generating nearly 30,000 direct and indirect jobs per year since 2002. In 2004, Bavaria ranked first in the brewing industry of Colombia, Ecuador, Panama and Peru, and is now the second largest brewing company in South America and the tenth in the world. In 2004, Bavaria's total production amounted to over 28.6 million hectolitres of beer and 5.8 million hectolitres of other beverages.

It was founded in Bogotá in 1889 as Kopp's Deutsche Brauerei Company. Since its creation, Bavaria has been one of the most important national companies and a reference model for the regional economy. The Santodomingo family has been a fundamental investor in this development. The Santodomingo family's involvement in the Colombian brewery market had begun in 1930, when it purchased two Atlantic coast companies, Cervecería Barranquilla and Bolívar S.A. In 1967 these two companies changed their names to Cervecería Águila S.A. The relationship between Bavaria and the Santodomingo family arose in 1967 with the acquisition of the Cervezas Águila by Bavaria. Cervezas Águila was acquired by Bavaria in return for a percentage of share capital representing more or less 22.0 % of the issued shares of Bavaria. The Santodomingo family thus entered Bavaria as a shareholder, and later increased its shareholding in the company.

Bavaria operated mainly in Colombia, which during this period presented a changing and often unstable political and economic environment. During most of the nineties, the Colombian economy experienced an extraordinary boom based on a combination of oil bonanzas and foreign exchange inflows. In this period, too, Colombia was confronted by two major events that affected its regular economic performance: an economic opening up in the early nineties and the severe international crisis that began in Asia in 1997 and spread to other emerging markets.

At the close of the nineties, the country faced the biggest economic crisis in its history, when GDP fell for the first time in seven decades, and public spending rose from less than one quarter to over one third of GDP. As from 2000, the Colombian economy began to recover. The macroeconomic imbalances which had accumulated during the nineties were countered by structural economic reforms. Nevertheless, in the first few years no significant results were achieved and, contrary to expectations, the symptoms of economic and political instability continued to intensify.

### *The Business Process*

In this context, Bavaria was undergoing a process of transformation that was to prove decisive for its future. In 1997, Bavaria embarked on a strategy of focalization. Like many other business groups it had been applying a strategy of diversification which had up to then enabled it to maintain a presence in different types of business. In 1997 Bavaria began the process of separation of the brewing and beverage companies, which continued to operate under the name of Bavaria S.A., while the remaining companies were split off to form a separate company, listed on the Bogotá Stock Exchange, called Valores Bavaria S.A. Valores Bavaria held investments in different sectors such as aviation, the media, telecommunications, oil and food products. This process culminated in a second split-off in 2001, all the brewing and beverage business being grouped together within the Bavaria Business Group (GEB).

By October 2001, Bavaria and Valores Bavaria had completed the split-off process and agreed to carry out a capitalization. The loans granted by Bavaria were converted into shares of Valores Bavaria in the name of Bavaria shareholders. The operation, which concluded in December 2001, distributed 2.17 shares of Valores Bavaria for each Bavaria stock. The aim was to make Bavaria S.A. administratively and financially independent of Valores Bavaria S.A. and ensure that each company focused entirely on its principal activity.

In the early years of the decade of 2000, Bavaria became aware of the need to grow or else face the decrease of its value creation in the future, and it therefore adopted an aggressive value-creation strategy, designed to consolidate the existing markets, conquer new ones and become an internationally competitive company.

Bavaria had ambitious expansion plans aimed at retaining the Colombian market, expanding in the Latin American area and becoming an attractive player in the world brewing business. At that time, it had no financial net liabilities and consequently had borrowing capacity, yet to fund an aggressive acquisition plan with borrowed resources meant that the future size of the acquisition plan would be limited by its borrowing capacity. According to García, the market value of Bavaria shares at that time was significantly lower than its going concern value, so that the issuance of new shares as a means of financing the process was not feasible. The panorama entailed countless management and financial challenges that included the impossibility of acquiring new shareholders as a result of the undervaluation of company's shares, the exhaustion of the local debt market and the risks involved in implementing a growth strategy in a volatile economic environment.

In the words of Juan Carlos García, a current member of the Board of Directors of Bavaria, "in 2000 the shareholders of Bavaria decided to expand the company as a preventive measure in view of the fact that the international players were also embarking on expansion processes". Expanding the company involved a number of challenges, among others that of management, which entailed continuing to administer the business

and at the same time implementing a successful acquisition strategy. How to lever such an aggressive expansion strategy and at the same time survive in such a competitive business as brewing at the international level? García explains that to facilitate this process the Board of Directors adopted two fundamental measures:

- The creation of a specialized management dedicated to optimizing existing operations - this made it possible to devote time to the geographic expansion of the company without abandoning the basic business; and
- The setting up of a team responsible for expansion through acquisitions and mergers, including internal resources and outside consultants, thus permitting consistent efforts to be dedicated to this initiative.”

### ***The Operation with IFC – An International Anchor Investor***

In order to successfully implement its strategy of focusing on beverages and becoming an important regional player (through acquisitions), while at the same time competing with multinational companies, Bavaria had to concentrate on improving and optimizing its operations and improving its access to the financial markets. If it was to accomplish this, Bavaria needed a provider of anchor capital to consolidate the confidence of other investors, particularly international investors. It was then that Bavaria’s Financial Vice-President, Mauricio Restrepo, contacted IFC, the World Bank Group’s investor in the private sector of developing countries, inviting it to participate in a credit operation capable of leveraging Bavaria’s growth strategy.

The size of the financing and Bavaria’s environmental conditions represented a challenge for the IFC. In the words of IFC’s Cecilia Rabassa, “at that time Colombia had no investment ranking, Colombia’s image in economic and political terms was not one of the best and the appetite of the international debt market was approaching exhaustion.” On the other hand, Bavaria’s expectations were in the region of \$300 million, if it was to go ahead with its planned acquisitions in Latin America.

The situation of Bavaria from the standpoint of any investor was somewhat peculiar, with an ambitious plan of expansion and major business expectations but in the midst of a volatile and unstable economic environment such as the Latin American market. In 2002, Bavaria was a major player in the Andean region, holding a significant share of the brewery market in Colombia, Panama and Ecuador. However, the time had come to look for an additional acquisition that would provide it with critical mass at regional level and consolidate its growth strategy.

Bavaria required high levels of investment to lever the conquest of one of the key elements in its regional expansion process, Peru. The operation with IFC would permit it to complete the resources necessary to continue its organic growth and at the same time embark on the acquisition of “Unión de Cervecerías Peruanas Backus y Johnston

(Backus)”, the largest brewery in Peru and the sixth largest in Latin America. Its capital requirements, however, were not only needed for this front. During 2002, Bavaria increased its shareholding in Cervecería Leona, a Colombian brewery with important developments in equipment and plants, which made it very attractive for the Bavaria Group. With this new operation, Bavaria acquired one of the most modern brewery plants in Latin America, which enabled it to modernize and optimize its own production processes, reduce the number of regional plants and thus optimize its operations and costs.

Despite having carried out the largest financing operation in the local capital market by placing bonds in Colombia with a value of US\$ 350 million (at terms ranging from 3 to 12 years), this level of financing was insufficient for the projects envisaged. Bavaria needed to access the international finance markets in order to continue funding its growth.

### ***“IFC Responds to Opportunities and Bavaria was a Great Opportunity to do Business”***

For IFC, however, the financing of Bavaria was a challenge owing to the size and environment of the operation. The structuring of the loan called for innovative solutions capable of overcoming a practical difficulty: a conventional loan structure was not good business for either party. For IFC, the level of risk was not economically justified by an ordinary debt return; on the other hand, Bavaria’s business plan did not allow it to repay in short- or medium-term. This situation resulted in an IFC loan (US\$30 million) being structured at 10 years, with a 10-year grace period and the right to convert into the company’s shares. This way, IFC could participate in the capital and improve its return while on the other hand, Bavaria would improve the financing terms by extending the average life of its loan obligations. In addition, IFC succeeded in raising a further US\$270 million of its own funds and those attracted from international and local banks to finance Bavaria’s expansion plans. The structure proposed by IFC was undoubtedly unusual for any operation, but even more so in the context of the conditions prevailing in Colombia at the time.

The IFC/Bavaria operation was good business for everyone. For Bavaria, because its priority was to gain access to the international markets lever its growth strategy and thereby generate added value for its shareholders. The presence of IFC signalled trust by a recognized multilateral investor and provided financing consistent with its expansion needs. For IFC, it was a great opportunity to assist in the development of economic activity in the region, transmit a message of confidence in the Colombian market, and confirm that investment processes in emerging markets can contribute efficiently to the generation of value in companies and, at the same time, make a profitable business transaction.

### ***The Key Elements of International Transformation***

A decisive element in Bavaria’s development during these years, as confirmed by several

people who had a first-hand knowledge of this process, was the entry of Alejandro Santodomingo and Carlos Alejandro Pérez as members of the Board of Directors of Bavaria. Alejandro Santodomingo Dávila is the second of the three sons of Señor Julio Mario Santodomingo; and Carlos Alejandro Pérez Dávila is his cousin. They both have a sound academic background and experience as investment bankers.

For Juan Carlos García, a current member of the Board of Directors of Bavaria, “one of the key elements facilitating the process of Bavaria’s international expansion was the entry on the Board of Directors of a new generation of shareholders with an international business approach and an expansive vision of the brewery business”. For Atul Mehta of IFC’s negotiating team, “the direct involvement of Alejandro Santodomingo and Carlos Alejandro Pérez, as representatives of the investor family and members of the Board of Directors, was crucial.”

For Mike Lubrano, Manager of IFC’s Corporate Governance Unit, “the entry of Alejandro Santodomingo and Carlos Alejandro Pérez illustrates the direct relation between corporate governance and business success. There are measures that definitely facilitate the success of the company and the family and at the same time understand the growth process and take into account the needs, expectations and new ideas of the members of the family connected with the business.”

From the Corporate Governance standpoint, the process of succession plays a fundamental role because it transforms the vision and facilitates company decision-making. The entry of Alejandro Santodomingo and Carlos Alejandro Pérez into the governance structure of Bavaria represented both a process of renewal of vision and a formula for speeding up the negotiation processes required for the company’s expansion. This situation, added to other factors such as the level of professionalism of Bavaria’s management team and the alignment of the interests of all the players on value-creation, played a decisive role in Bavaria’s internationalization process, both as regards financing and as regards the acquisition of companies in other countries.

### ***Financing with the International Finance Corporation***

The operation with IFC had the following terms: a loan of US\$70 million for 10 years, with a 2-year grace period at a rate of Libor + 3.5%. Also, a “B” loan of US\$200 million was granted by a group of national and international banks for 5 years at a rate of Libor + 2.75% during the first year. Finally, the transaction included an IFC “C” loan of US\$30 million convertible into Bavaria’s shares granted for 10 years.

The deal was approved on 13 June 2002 and the funds were disbursed on 18 June 2002.

For the IFC, the transaction with Bavaria was a true example of responsible investment

contributing to the development of the private sector in emerging economies. “The Corporation’s involvement was not limited to the provision of capital, it assisted in the process of value creation for the shareholders of the company, with the ensuing positive effect on the Colombian economy,” according to Athul Mehta, an IFC officer.

The transaction was a success. It was recognised as the transaction of the year in 2002 by Euromoney. This recognition of a transaction which responded innovatively to financing complex problems, contributed to value creation and provided a further impetus to the growth of the private sector in Latin America.

### *Corporate Governance and the IFC*

IFC’s biggest influence on value-creation was its emphasis on the improvement of Bavaria’s Corporate Governance policies and practices.

Corporate Governance is concerned with the structures and processes relating to the management and control of companies, including the relations between the management, board of directors, shareholders and other stakeholders. Corporate Governance is a strategy of corporate self-regulation establishing the rules of the game for making business decisions and it is a concept that has steadily been gaining prevalence and visibility for investors worldwide.

The concept of Corporate Governance reached Bavaria, as it reaches most companies, through different channels simultaneously but not all delivered a true recognition of its importance. To the executives of Bavaria the words “*corporate governance*” were not unfamiliar; but nevertheless it was the business needs and regulatory requirements events that triggered the process of implementation of good Corporate Governance practices in Bavaria.

“The discussions on the implementation of good Corporate Governance practices arose mainly as a result of the plans for financing the acquisitions. The first Corporate Governance reform was motivated by the need to adapt to changes in Colombian law, while preparations were being made to access the Colombian long-term bond market. The changes to the By-laws, on the other hand, were the result of negotiations with the creditors led by IFC, and were incorporated by the management and board of directors in the knowledge and awareness of the benefits they entailed”, according to Juan Carlos García.

For Bavaria, the introduction of good Corporate Governance measures facilitated the company’s access to international capital markets, improved its business performance through more structured decision-making procedures, and contributed to the structuring of a long-term vision consistent with the interests of all stakeholders.

Corporate Governance is an essential element of IFC’s investment processes. Therefore, a

large part of the decision to invest in Bavaria was motivated by the company's commitment to the principles of good Corporate Governance. From IFC's perspective, Corporate Governance is important because it enables to mitigate the risks inherent in its investments and to add value to the client-companies, fulfilling its mission of promoting sustainable private sector investment in developing countries.

Working hand in hand with its customers makes it easier for IFC to manage reputational risks. At the same time, allow IFC to contribute to the development of local capital markets through better standards or transparency and accountability.

The self-regulation process of Corporate Governance, whereby a company autonomously assumes commitments to regulate its management and control independently of the regulatory environment in which it operates, permits the IFC to invest in companies operating in unstable regulatory environments.

### ***IFC Holds the View that Corporate Governance is not a Destination but a Road***

The history of the introduction of good Corporate Governance practices in Bavaria began in April 2002, with the adoption of a Code of Good Corporate Governance. This was a consequence of the fact that Colombian legal regulations established the obligation of adopting a Corporate Governance code for issuers of securities seeking investment from pension funds in Colombia. Pension funds are the largest institutional investors, with a portfolio which in 2006 totalled some 18 billion dollars.

IFC's involvement with Bavaria began with a visit in April 2002. At that time, IFC applied its Corporate Governance Methodology ("the IFC CG Methodology"). The IFC CG Methodology is a set of tools (matrices, questionnaires, document request lists, etc.) to be applied systematically to identify the main governance risks and opportunities in client companies. The Methodology is developed by the IFC based on their experience and knowledge as investors and is tailored to cover five types of companies: listed, family/founder-owned, State-owned, recently privatized companies and financial institutions.

The aim of the Methodology is to draw to the attention of IFC's investment officers and of the management teams of IFC's customers issues of vital importance in relation to Corporate Governance and to identify the risks and opportunities in each company. In Lubrano's words, "our approach is not that of a checklist, in which a series of measures are described. The idea is to place on the table different questions vital to the sustainability and growth of our customers and work with them in designing a strategy for adding value."

"Bavaria was one of the first listed companies in which the IFC had the opportunity of formally applying the Methodology. Bavaria represented a landmark in the improvement of the Methodology, since it helped us to realize that it was an evolving product and to

ascertain the strengths and weaknesses of the tools. I believe we all learnt a great deal from the operation,” Mike Lubrano says.

In the case of Bavaria, the Methodology for assessing Corporate Governance issues in family-owned and listed companies was used. At the time, the IFC team felt that the greatest challenge was to determine the actual level of commitment of the shareholders and senior executives of Bavaria to Good Governance principles. Although Bavaria had recently adopted a Good Governance Code to comply with the local regulations, it was essential to determine whether a commitment existed for an overall reform meeting international standards of Corporate Governance.

The situation with the recently-implemented spin-off between Bavaria and Valores Bavaria called for special attention. Another major concern was the structure and composition of Bavaria’s Board of Directors. The process of preparation of financial information and the monitoring and control exercised by the Board of Directors were other fundamental issues.

“What made Bavaria a good client from the Corporate Governance standpoint was the fact that the company’s management team was conversant with and had commenced the implementation of good practices some time ago before the transaction with IFC, and this enabled us to make rapid progress with the sole aim of adding value to the company and facilitating its transition to the international market,” Lubrano states.

### ***Corporate Governance Issues in Bavaria***

The board of directors is the highest-level governance body in any company and is responsible for safeguarding the interests of the shareholders as the owners of the company. For this reason boards are a vital institution for the implementation of Corporate Governance.

In 2002, Bavaria had a Board of Directors composed of five (5) members, with no independent members and no formal Board committees.

The central area of concern from the governance perspective was the functioning Board of Directors. Accordingly, IFC suggested that Bavaria set up Board committees composed of independent members entrusted with regulating potential conflicts of interest arising in commercial relations or transactions between group companies or in operations in which any of its shareholders might be involved. Further, IFC worked on the establishment of an audit committee of the Board of Directors that would examine in detail the accounting practices on the basis of which the account-rendering process and the review and improvement of the internal and external audits would be carried out.

For these purposes, it was essential to develop and incorporate a clear definition of an independent Board member. The introduction of independent directors would strengthen the confidence of investors, who would have no direct presence on the Board of Directors,

that the interests pursued by the management would equally reflect the interests of all the shareholders.

For IFC, an audit committee with independent members would facilitate the linking together of three fundamental issues for the company at that time: the need to strengthen and render the role of the Board of Directors in the company's financial and audit activities; the need to reinforce Bavaria's existing model of control and auditing; and finally, the incorporation of an international accounting language that would help make the company's performance more understandable for international investors.

For IFC as a creditor and potential shareholder, the treatment and rights of shareholders were fundamental. It was therefore essential to secure the company's commitment to show the true interest and value that Corporate Governance represented for all the shareholders.

Two points were of overriding importance:

- The terms of sale of the minority shareholders in cases of change in control (*tag-along rights*) - this measure had recently been introduced as a result of the local regulations and subsequently developed in internal documents of the company; and
- The possibility of specialized audits being carried out by groups of shareholders owning at least 10% of the share capital.

These measures were of critical importance for reducing agency costs. The protection of minority shareholders in situations of changes in control, i.e., the tag-along rights, had been introduced by the Colombian regulations, which made it compulsory for acquisitions involving more than 10% of the equity capital to be carried out by means of a Public Takeover Bid (PTB). Bavaria included these provisions in its Good Governance Code in April 2002.

### ***Process of Regional Consolidation and Growth***

With the changes introduced in Corporate Governance policies and practices, an internationalization strategy in progress and medium- and long-term goals set, a number of acquisitions were carried out that contributed to the sustainability and growth of the company.

As a result of the deal with IFC, Bavaria now had resources available to purchase the Peruvian company Cervezas Backus. In July 2002, it acquired from the Brescia Group 21.9% of the voting shares of Backus for US\$ 420 million. Through this transaction, Bavaria was to acquire one of the most traditional companies in Peru and consolidate its position as Latin America's most prestigious brewery.

The transaction entailed major changes for the owners of Backus and led the Polar Group, which held 22.1% of the Backus shares, to accuse Bavaria of planning a change in control in conjunction with the Cisneros Group. The acquisition of 21.9% of the voting shares of Backus had been effected outside the stock market, for a price per share of \$21.95 US dollars, twice the price quoted on the Lima Stock Exchange at the time. Backus argued that the same terms should have been offered to all shareholders. The transaction was, however, legally correct since the Peruvian regulations did not require the launch of a public takeover bid (PTB) in the case of transactions involving less than 25% of the capital stock.

In December 2002, Bavaria decided to increase its holdings in Backus by acquiring Polar's interest for the total sum of US\$ 567.8 million, paying US\$ 27 per share. It also decided to make a PTB offering the same price paid by Bavaria to Polar to all minority shareholders. This new operation brought the dispute to an end inasmuch as all the shareholders were offered the opportunity of selling their shares for a price that was even higher than in the first acquisition. This PTB enabled Bavaria to acquire 1.17% of the class A voting shares of Backus for US\$23.3 million, thereby gaining control of 60% of the voting stock of Backus.

Julio Mario Santodomingo, Chairman of the Board of Directors of Bavaria at the time, said: "In terms of strategic investment in the brewery sector, Backus is one of the most attractive companies and a perfect match for Bavaria. In particular, Backus is the leader in a market in which beer consumption is growing, with unbeatable brand names and a first-class management team. By extending Bavaria's presence in the Andean Region we are strengthening our position within an industry that is undergoing a process of consolidation worldwide. We believe this investment will deliver significant value to the shareholders of Backus and to the shareholders of Bavaria." Within a short space of time, Peru became the second most important country for Bavaria sales, having reached a figure of US\$900 million in sales in 2004.

By 2003, the effects of the changes were conclusive. The figures released by the company showed that between 2002 and 2003 there had been a significant increase in sales, from the 1.5 billion dollars registered in 2002 to 2.4 billion dollars in 2003, representing an increase of nearly 80%.

The growth of Bavaria meant heavy financing requirements, and it was therefore fundamental to continue with the structuring of financing resources at internationally competitive rates and sufficient terms of repayment. Thus, in October 2003, Bavaria placed US\$ 500 million-worth ordinary bonds ("Senior Notes") at 8-7/8% in the capital markets of the United States and Europe.

Bavaria's financial team, led by Mauricio Restrepo, decided to use for this issue investors qualifying within the terms of the rule 144A of the United States Securities Act. This private/qualified offering permitted Bavaria to raise the necessary capital to honor the obligations it had acquired in its expansion process. This issue represented the largest

placement of international bonds by a private company in the Andean Region. The Corporate Governance decisions adopted in 2002 had created the necessary basis for Bavaria's successful access to the developed capital markets.

The international market was the last stage of the road that had been embarked upon to lever Bavaria's strategy of expansion and growth. As Juan Carlos García puts it, "at the time the 144A bonds were placed, Bavaria had already successfully accessed both the corporate bond market in Colombia and the secured syndicated loan market. In both cases, borrowing capacity had been used up to the full amounts those markets were able to provide. The 144A bonds represented an alternative for the long-term financing of significant amounts through sophisticated investors capable of understanding Bavaria's expansion strategy. In addition, the bonds were an unsecured obligation consistent with the financing and acquisition operations previously carried out".

Bavaria's entry into the international markets had been facilitated by the process of adoption of international standards within the framework of the IFC loan. For Juan Carlos García the concerns in this placement were of two kinds: "internal, associated with the *Indenture* obligations required to make the placement feasible. A great many decisions had already been taken as a consequence of the syndicated loan led by IFC, so that these concerns were resolved. On the other hand, there were also external concerns relating to the Latin American high-yield debt market: given its natural volatility, for how long would this market remain available and what would be the cost of accessing it?" The placement proved to be a success. With this, Bavaria showed itself to be a company that had progressed beyond the local growth thresholds and was now emerging as a strong competitor in the international brewery market.

### *The Conversion of IFC from Creditor to Shareholder*

By 2005, Bavaria presented the image of a sound company, offering low risk levels and inspiring strong confidence among its interest groups. Duff & Phelps of Colombia had confirmed the AAA rating of its ordinary bonds and the process of conversion of the debt denominated in US dollars to Colombian pesos had been successful. The share of the debt denominated in US dollars the total indebtedness of Bavaria had decreased from 62.3% in December 2003 to 25.6% in May 2005. The denomination of debt in US dollars in an economy prone to devaluation, as had traditionally been the case in Colombia, was one of the greatest risks for the company's long-term vision. Furthermore, the balance of Bavaria's gross indebtedness had been reduced between June 2004 and May 2005 from 6.07 billion to 4.72 billion pesos.

Thus a bonanza situation had arisen, as a result of decisions correctly thought out, implemented and monitored, which made the company attractive to any investor. That is why, in March 2005, the IFC exercised its right of conversion of the US\$ 30 million loan, which it had advanced to the company in 2002, into 2,356,890 shares in Bavaria. Paolo Martelli, IFC's Director for the Andean Region, stressed a number of elements in the decision to convert: "the commitment and positive attitude of the Bavaria management

team, added to other related variables such as social responsibility, the environment, transparency and Corporate Governance, definitely facilitated the conversion of IFC into a minority shareholder of Bavaria”.

The then Chairman of Bavaria, Ricardo Obregón, stated: “the loan from IFC is one more step on the road leading to Bavaria’s transformation into a multinational beverage company meeting the highest international standards of production, marketing, Corporate Governance and environmental protection. At the same time, this project partnered by Bavaria and IFC is an outstanding example of public and private cooperation that will encourage economic development and employment in the region.”

IFC became Bavaria stockholder, IFC was now a minority shareholder in one of Latin America’s most important business groups.

### *The SABMiller - Bavaria Merger*

Bavaria was the key to the Latin American market for the major players in the world brewery market. Accordingly, the major international players showed interest in the company. On 18 July 2005, a merger agreement was announced under which SABMiller, the second largest brewery in the world, merged with Bavaria, in the biggest commercial operation in the history of Colombia. Involving a total sum of approximately US\$ 7,800 million, one of the most interesting stages in the process of expansion and growth of a Latin American company was concluded.

The agreement provided that the Santodomingo Group, a major shareholder in Bavaria, would receive a 15.1% holding in SABMiller, and would participate in the governance through two seats on the board of directors of the SABMiller regional group (currently represented by Alejandro Santodomingo and Carlos Alejandro Pérez). The transaction was highly beneficial to both parties. It permitted Bavaria to lever its international growth based on the experience, recognition and financial and administrative capacity of a company like SABMiller. For SABMiller, it was the doorway to Latin America, considered to be the region with the highest growth potential for the world brewery market.

The sale of its shareholding to SABMiller yielded IFC a profit of over 50%. IFC sold its shares for the per share price of US\$ 19.48. This was the final price offered by SABMiller to all the shareholders in a voluntary PTB on the Colombian Stock Market.

### *Conclusions*

The process of regional expansion and the financing plan, added to the introduction of Corporate Governance practices, enabled Bavaria to sell itself as if it would be operating in a developed market rather than in an emerging market.

Several conclusions focusing on the relation between Corporate Governance and the

success of the business can be drawn from this case:

- The process of business growth requires professional and structured management and control in order to facilitate the decision-taking made necessary by global competition. In today's highly competitive environments, a strategy to preserve the local market is not enough, a business attitude and growth strategy is needed.
- The conquest of new markets as a value-creation strategy requires the confidence of the providers of capital to lever expansion plans. The adoption of Good Corporate Governance practices is a fundamental element in the creation of an environment of confidence among interest groups and to facilitate access to sufficient financial resources to lever a strategy of this type. Clarity of ownership structures, transparency and minority shareholder rights' protection played a fundamental role in this process.
- The participation and responsibility of the investors in the adoption of Good Corporate Governance practices is decisive in the process of value creation, particularly in volatile political environments (as is commonly the case in developing economies). The participation of IFC in Corporate Governance issues aided the strategy of growth and expansion designed by the company.
- The conversion right granted to the IFC played a fundamental role by providing a different incentive from that of a mere guarantee for the creditor, namely, a value-creation incentive as a potential minority shareholder.
- The incorporation of Corporate Governance practices adds value because it institutionalizes the processes of business decision-taking and thereby helps to consolidate the confidence of interest groups.
- The adoption of Corporate Governance should be aligned with the company's strategic targets and accompanied by a respectful and gradual process of change in the culture of the organization and its interest groups.