



# Practical Guide to Corporate Governance

Experiences from the Latin American Companies Circle

Motivation



Copyright © 2009 International Finance Corporation  
2121 Pennsylvania Ave. NW, Washington, DC 20433  
United States of America

*A Member of the World Bank Group*

All rights reserved.

The findings, interpretations and conclusions expressed in this publication should not be attributed in any manner to the International Finance Corporation (IFC), Organisation for Economic Co-operation and Development (OECD) and their affiliated organizations, or members of their Boards of Directors or the countries they represent. IFC and OECD do not guarantee the accuracy of the data included in this publication and accept no responsibility for any consequences of their use. The information on companies, prepared by the members of the Companies Circle of the Latin American Corporate Governance Roundtable, reflects such companies' own management's and the board of directors' view of the motivations, challenges, solutions and rewards for devising and putting in place better governance rules and practices.

The material in this work is protected by copyright. Copying and/or transmitting portions or all of this work may be a violation of applicable law. IFC and OECD encourage dissemination of this publication and hereby grant permission to the user of this work to copy portions of it for the user's personal, noncommercial use, without any right to resell, redistribute, or create derivative works here from. Any other copying or use of this work requires the express written permission of IFC.

# Practical Guide to Corporate Governance

Experiences from the Latin American Companies Circle

## **International Finance Corporation (IFC)**

The International Finance Corporation (IFC) is part of the World Bank Group and was established in 1956 to encourage private sector-led growth in developing countries. IFC fosters sustainable economic growth in developing countries by financing private sector investment, mobilizing capital in the international financial markets, and providing advisory services to businesses and governments. IFC helps companies and financial institutions in emerging markets create jobs, generate tax revenues, improve corporate governance and environmental performance, and contribute to their local communities.

In Latin America and the Caribbean, IFC focuses on key development challenges facing the region. We work to improve the business environment, broaden and deepen access to finance, and encourage infrastructure development. IFC's strategic priorities for the region also include

“Promoting sustainability – environmental and social, and corporate governance standards”.

The goal is to improve lives, especially for the people who most need the benefits of growth.

## **Organisation for Economic Co-operation and Development (OECD)**

The Organisation for Economic Co-operation and Development (OECD) is a unique forum where the governments of 30 democracies work together to address the economic, social and environmental challenges of globalisation, in close co-operation with many other economies. One of these challenges is corporate governance, a topic on which the OECD has developed internationally agreed Principles of Corporate Governance, which have served as a basis for regional policy dialogue programmes throughout the world. The Latin American Roundtable on Corporate Governance, which meets annually, is one such initiative, organized by the OECD in partnership with the IFC/World Bank Group and with the support of the Global Corporate Governance Forum. In this way, the OECD provides a setting where governments and other stakeholders can compare experience, seek answers to common problems, identify good practice and work to co-ordinate domestic and international policies.

## **Global Corporate Governance Forum (GCGF)**

The Global Corporate Governance Forum is an International Finance Corporation (IFC) multi-donor trust fund facility located within IFC Advisory Services. The Forum was co-founded by the World Bank and the Organisation for Economic Co-operation and Development (OECD) in 1999. Through its activities the Forum aims to promote the private sector as an engine of growth, reduce the vulnerability of developing and transition economies to financial crisis, and provide incentives for corporations to invest and perform efficiently in a socially responsible manner. The Forum sponsors regional and local initiatives that address the corporate governance weaknesses of middle- and low-income countries in the context of broader national or regional economic reform programs. In addition to the IFC, the Forum is currently funded by the governments of France, Luxembourg, The Netherlands, Norway and Switzerland.

# Contents

viii	<b>A Word from the Chair About the Companies Circle</b>
xi	<b>Foreword</b>
xiii	<b>Acknowledgements</b>
1	<b>Introduction</b>
9	<b>Chapter 1 Motivation: The Whys Define the Ways</b>
13	<b>1 Accessing Capital or Reducing the Cost of Capital</b>
14	1.1 Good Governance Leads to Higher Market Valuation
17	1.2 Attracting and Retaining Shareholders
19	1.3 Decreasing Cost of Capital, Diversifying Capital Structure
20	<b>2 Facing and Responding to External Market Pressures</b>
21	<b>3 Balancing (Sometimes) Diverging Shareholder Interests</b>
23	<b>4 Resolving Governance Issues in Family-Owned Businesses</b>
26	<b>5 Ensuring Company Sustainability</b>
28	5.1 Attracting and Retaining Managers to Ensure Strategy Implementation
29	<b>6 Achieving Better Operational Results</b>
33	<b>Chapter 2 Purpose Alignment: Changing Attitudes and Generating Commitment</b>
36	<b>1 Agree on the Common Vision; Align Interests</b>
36	1.1 Overcoming the Agency Problem: Bringing the Interests of Managers and Owners Together
37	1.2 Identify Corporate Governance Champions
38	1.3 Building a Common Understanding from Top to Bottom
42	1.4 Understanding Sources of Resistance; Taking Actions to Overcome
44	<b>2 Changing Attitudes</b>
47	<b>Chapter 3 Planning and Setting Priorities</b>
50	<b>1 Setting the Priorities</b>
51	1.1 Motivations Drive Prioritization
53	<b>2 The Role of Benchmarking</b>
55	<b>3 Sources of Advice and Guidance</b>
58	<b>4 Less Is More: Design an Easy-to-Understand Roadmap</b>

<b>61</b>	<b>Chapter 4 What to Do: Key Good Governance Practices</b>
64	<b>1 Formalizing Governance Policies: Codes and Guidelines</b>
69	<b>2 Functioning of the Board of Directors and Relations with Executive Management</b>
69	2.1 The Board of Directors: Governance Machine
71	2.2 The Board's Composition: Size, Skill Mix and Experiences
73	2.3 Director Independence
75	2.4 Specialized Committees: Analyzing Matters In-Depth
80	2.5 Board Procedures
81	2.6 Better Boards Require Performance Evaluation
83	2.7 Board Effectiveness Requires Attention to Various Details
85	2.8 Relationship Between the Board of Directors and Senior Management
89	2.9 The Board Chairperson/CEO Relationship
91	2.10 Succession Planning for Senior Executives
94	2.11 Monitoring Systems to Measure Performance and Management Evaluation and Compensation
95	<b>3 Strengthening of Shareholder Rights and Maintaining Alignment</b>
96	3.1 Organizing Shareholders Meetings
98	3.2 Shareholders Meetings in Companies with a Large Shareholder Base
101	3.3 Tag-Along Rights
104	3.4 Creating Clear Rules to Address Conflicts of Interest
105	<b>4 Improving the Control Environment</b>
109	<b>5 Transparency and Disclosure of Information</b>
110	5.1 Organizing Information Disclosure
112	5.2 Communication with the Market: Much More than Transparency
<b>119</b>	<b>Chapter 5 Governance Challenges for Family-Owned Businesses</b>
122	<b>1 Family Business Edge</b>
125	<b>2 Family Business Governance Challenges</b>
127	<b>3 Governance Solutions to Family Business Challenges</b>
129	3.1 Distinguishing Governance Solutions in Different Ownership Stages of the Family Business
130	3.2 Family Governance Institutions
132	3.3 Family Governance Documents
133	3.4 Specific Solutions to Some Family Governance Challenges
135	3.5 Succession Planning in Family-Owned Business
<b>145</b>	<b>Chapter 6 Implementing Governance</b>
147	<b>1 Implementation Takes Time</b>
149	<b>2 Governing Governance</b>
152	<b>3 Monitoring the Progress of Implementation</b>
154	<b>4 Interim Procedures and Situations in Transition</b>
155	<b>5 Communicating Changes</b>
157	5.1 Convincing the Skeptics
160	5.2 Learning from Outsiders' Reactions
162	<b>6 Pursuing Best Practices Is a Continuous Learning Process</b>

<b>167</b>	<b>Chapter 7 The Tangible Benefits of Good Governance</b>
170	<b>1 Overall Approach to the Comparative Analysis</b>
171	1.1 Analysis Features Five Approaches
172	<b>2 Impact of Corporate Governance on Operational Indicators</b>
172	2.1 Comparison of Traditional Accounting Indicators
174	2.2 The Second Approach: Economic Profit Analysis Reveals Positive Results
176	<b>3 Impact of Corporate Governance on Cost of Capital</b>
176	3.1 Comparison of Traditional Stock Market Indicators
178	3.2 Analyzing the Impact of Governance Improvement Announcements
179	3.3 The Bottom Line: Analyzing Total Stock Returns
182	3.4 How Robust Are the Results?
183	<b>4 Benefits of Good Governance During the Recent Financial Crisis</b>
183	4.1 Comparing Operational and Market Indicators
186	4.2 Analyzing the Stock Market Reaction of Circle Members in 2008
188	4.3 Corporate Attributes Affecting Better Stock Performance During an Economic Shock
189	<b>5 Companies Circle Members Acknowledge Gains</b>
<b>195</b>	<b>Appendix 1 IFC Corporate Governance Progression Matrix</b>
<b>197</b>	<b>Appendix 2 Organizations Involved in Corporate Governance</b>
<b>201</b>	<b>Appendix 3 Corporate Governance Benchmark Questionnaire</b>
<b>227</b>	<b>Appendix 4 Indicative Independent Director Definition</b>
<b>229</b>	<b>Appendix 5 Methodology for Chapter 7 Analysis</b>
<b>241</b>	<b>References</b>
<b>249</b>	<b>Glossary</b>
<b>257</b>	<b>Index</b>



## A Word from the Chair about the Companies Circle

I am pleased to share with you this great initiative from the Latin American Companies Circle—a very special moment in its history.

The Companies Circle was launched in May 2005 by recommendation of the Latin American Corporate Governance Roundtable—a network of public officials, investors, non-governmental institutes, stock exchanges and associations as well as others interested in corporate governance improvement in the region. It brings together a group of Latin American companies in order to provide private sector input into the work of the Roundtable and to share with each other and the public their experiences in putting principles of good corporate governance into practice. The Companies Circle is composed of 14 member companies from five countries that have demonstrated leadership in embracing good corporate governance practices, helping to build stronger businesses and companies: Atlas from Costa Rica; Argos and ISA from Colombia; Buenaventura and Ferreyros from Peru; Homex from Mexico; and CCR, CPFL, Embraer, Marcopolo, Natura, NET, Suzano and Ultrapar from Brazil.

The members of the Companies Circle are firms whose securities are listed on local and international exchanges and who have a significant presence in their capital markets. Their experiences are of most immediate relevance to listed companies. However, Companies Circle members believe that many of the steps they have taken in areas such as boards of directors, shareholder and stakeholder relations, internal controls and transparency also present important lessons for closely-held private corporations, including family firms. Accordingly, the efforts to share experiences with other firms in the region are not limited to the community of large, listed companies.







These 14 member companies work together in order to:

- Promote better governance in the region by improving the understanding of corporate governance and assist in developing policy responses
- Promote an ongoing dialogue on experiences between private and public sectors
- Monitor and evaluate corporate governance progress in the region
- Identify demand for technical assistance and encourage the creation of supply to respond to such demand
- Inform the international community about national and regional reform initiatives.

Today the Companies Circle does more than share experience. It works to be recognized as a knowledgeable, experienced and active think-tank on corporate governance practices in Latin America.

This book constitutes the result of our efforts to attain this ambitious mission. We are confident that these efforts will also help all corporate governance enthusiasts to develop a culture of values for professional and ethical behavior, on which the well-functioning of markets depends.

Enjoy the reading,

Andre Covre  
Chairman of the Companies Circle





# Foreword

In a short time, the Latin America Companies Circle has become one of the most vibrant and effective advocates for corporate governance improvements across the region. The Circle was established in 2005 by the International Finance Corporation (IFC) and Organisation for Economic Co-operation and Development (OECD), at the request of the Latin American Roundtable on Corporate Governance. It quickly gained a reputation for the generous and open way that its members shared their experiences in awareness-raising events throughout Latin America. The experiences of Companies Circle members in building better corporate governance rules and practices are highlighted in their previous publication, *Case Studies of Good Corporate Governance Practices*.

The IFC's and OECD's joint efforts with regional and local partners to improve corporate governance, in Latin America and globally, have led to real progress at both company and policy level. An important initial result was the stage-setting *White Paper on Corporate Governance in Latin America* from the Latin American Roundtable on Corporate Governance. Progress includes legal and regulatory reforms, the development of country codes of best practice, the creation of advocacy and support institutions, the pioneering efforts of the Novo Mercado in Brazil, and heightened attention to corporate governance by many market participants. But improvements are not universal and more needs to be done.

As the Companies Circle demonstrates, the business community is an important driver for reform. While policymakers and regulators have a key role in setting the overall framework, it is the private sector that ensures successful implementation on the ground. We therefore welcome this initiative by some of Latin America's leading listed firms to develop this *Practical Guide to Corporate Governance: Experiences from the Latin American Companies Circle*. It is the first guide of its kind produced for Latin American companies and reflects a diverse range of company experience from the region. Its practical, hands-on guidance and tangible, relevant examples should be of enormous help to companies starting on the path to improved corporate governance.

When the idea of creating this guide was born, markets around the world and in Latin America in particular were expanding rapidly and successfully. Part of that expansion was no doubt due to corporate governance advances in the region. Today, the global economic situation is changed, with the widespread financial crisis and economic downturn. But the crisis underlines the importance of strong corporate governance to build strong companies. The *Practical Guide* could not have come at a better time.

We are convinced that this guide will be widely disseminated and used by Latin American companies, resulting in further improvements in their corporate governance. We would like to thank all of the members and supporters of the Companies Circle and particularly its able Chairmen Roque Benavides of Buenaventura in Peru, Carlos Yepes of Argos in Colombia, and Andre Covre of Ultrapar in Brazil. They have all played an important role in making the Companies Circle such a success.

Toshiya Masuoka



Director of Corporate Advice Department  
International Finance Corporation

Carolyn Ervin



Director of Financial and Enterprise Affairs  
Organisation for Economic Co-operation and  
Development



# Acknowledgments

The preparation and publication of this Practical Guide has involved the participation and efforts of a large number of dedicated people and has been a productive, collaborative effort.

On behalf of the International Finance Corporation and the Organisation for Economic Co-operation and Development, we would like to express our sincere gratitude to Sandra Guerra, the Circle's coordinator, for all her efforts in the production of this guide. Ms. Guerra was instrumental in conceiving and developing the outline of the guide and preparing the first draft of the guide by patiently soliciting, collecting, coordinating and editing the input from the Companies Circle members. Ms Guerra diligently worked with the sponsoring organizations to further improve the original draft.

Our sincere thanks go to the many companies and individuals whose efforts have helped make this guide a reality. Their support has been a constant ever since the first meeting of the Companies Circle in May 2005 when the kernel of the idea began to form.

The guide weaves together concepts and contributions from numerous shareholders, board directors and key managers, representing 14 firms, based in five countries across Latin America. They share a common bond—a commitment to enhancing and diffusing knowledge of best governance practices. The pages of the guide reflect this strong commitment and we are deeply indebted to them.

Our contributors have supplied mountains of qualitative and quantitative data. They have dedicated their valuable time to explore their reasoning and motivations in implementing better corporate governance practices. And they have articulated both the highs and the lows of the experience. Their willingness to undertake this enormous amount of work has resulted in an extremely practical, wide-reaching volume that does not merely narrate events. Instead, the book highlights motivations and methods, details quantifiable results, offers helpful lessons from real experiences and provides clear guidance on steps to take.

In some cases, contributors who started the journey with us and whose enthusiasm for the cause far exceeded our expectations have moved on. We are grateful that their successors have maintained their level of commitment and input.

Our deepest appreciation goes to the dedicated individuals of Companies Circle member-firms who made this work possible and who secured the contributions of key participants: Maria Uriza and Carlos Raul Yepes at Argos; Diego Artiñano and Roberto Truque Harrington at Atlas; Roque Benavides and Daniel Dominguez at Buenaventura; Eduardo Andrade, Francisco Bulhões, Silvia Salmeron, Renato Vale and Massami Yueda at CCR; Marco Da Camino Soligo, Gisélia da Silva, and Wilson Ferreira at CPFL; Anna Cecilia Bettencourt Cochrane, Carlos Eduardo Camargo and Antonio Luiz Pizarro Manso at Embraer; Mariela Garcia de Fabbri and Patricia Gastelumendi Lukis at Ferreyros; Eustaquio De Nicolás Gutierrez, and Javier Romero at Homex; Juan David Bastidas Saldarriaga at ISA; José Rubens De La Rosa and Thiago A. Deiro at Marcopolo; Helmut Bossert, Fernando Mesquita, José Guimarães Monforte, Pedro Passos and Moacir Salzstein at Natura; João Elek, Leonardo P. Gomes Pereira and Marcio Minoru Miyakava at NET; Maria Cecilia de Castro Neves, David Feffer, Andrea Pereira, João Nogueira Batista and Bernardo Szpiegel at Suzano; and André Covre, Marcelo De Simone, Maria Fernanda Leme Brasil, Fabio Schvartzman and Pedro Wongtschowski at Ultrapar.

The determination of the three sponsoring organizations and their leaders—Darrin Hartzler of IFC, Mats Isakson of OECD and Phil Armstrong of the Global Corporate Governance Forum—helped ensure that the guidebook idea would become a reality.

Gratitude also goes to the hands-on efforts of several individuals—former and current staff at the sponsoring organizations. Mike Lubrano embraced the challenge of putting this guide together when he was the manager of the Corporate Governance unit at IFC, and continued as a tireless supporter of the work after he left IFC. Without him, this guide would not be in people's hands today. Nancy Metzger, at the GCGF when the project began, proposed

and implemented practical solutions to help the team overcome complex operational challenges. Santiago Chaher, her successor, demonstrated the same level of dedication and insight. Cuauhtémoc Lopez-Bassols of OECD had also provided valued support to this project.

Alexandre Di Miceli da Silveira, PhD and MSc, Professor of Accounting and Finance, School of Economics, Business and Accounting at the University of Sao Paulo, proposed the research framework for the last chapter. He supervised the data collection and analysis that formed the basis of the results detailed in this chapter. We are grateful for his extensive contributions.

Corporate governance is a continuum. As circumstances change over time, corporate governance efforts will change as well. We hope this volume will serve as companion and guide

for those interested in addressing governance at their firms, no matter where they are along the continuum.

Daniel Blume, Principal Administrator of OECD's Corporate Affairs Division.

A handwritten signature in black ink that reads "Daniel Blume". The script is fluid and cursive, with the first name and last name clearly distinguishable.

Davit Karapetyan, Corporate Governance Officer of the IFC Corporate Governance Unit.

A handwritten signature in black ink. It is a stylized, cursive signature that appears to read "Davit Karapetyan". The signature is written with a single continuous stroke, with some loops and flourishes.

# INTRODUCTION





# Introduction

An initiative of 14 leading Latin American companies, ***Practical Guide to Corporate Governance: Experiences from the Latin America Companies Circle*** distills the lessons learned from their experiences in improving their own governance. The book is intended as a roadmap to guide other Latin American companies interested in improving their corporate governance.

Although the guide has been in the works for several years, the timing of its publication coincides with a global financial crisis that has catapulted corporate governance to a top spot on the global policy agenda. With gaps in governance—from inadequate risk management to distorted incentives structures—factoring in as contributing to the crisis, good corporate governance practices will be an important part of the response needed for Latin American economies, as well for others around the world.

Beyond the immediacy of the crisis, Latin America possesses a unique set of corporate governance and market characteristics: a predominance of conglomerates and a highly-concentrated, frequently family-based ownership structure. In addition, domestic capital markets are still in the early stages of development. All of this poses special challenges to attracting investment and elevates the importance of governance practices. Among the challenges: ensuring that minority shareholders are confident enough to invest in listed companies by enhancing the protection of shareholders' rights and interests.

Within this context, there has been a remarkable growth in awareness and activity surrounding corporate governance during the last decade, as recognized by the Latin American Roundtable on Corporate Governance. This is an ongoing initiative of the Organisation for Economic Co-operation and Development and the International Finance Corporation/World Bank Group that has brought together policy-makers, regulators, stock exchanges, investors, companies and other stakeholders on an annual basis to promote improved policies and practices specific to the Latin American context. The Roundtable's White Paper on Corporate Governance in Latin America, issued in 2003, was a first attempt to outline public policy priorities and good practices specific to the region. Recognizing that much remains to be done, the Roundtable followed this with the establishment of the Companies Circle in 2005 to promote corporate governance implementation at the company level.

This practical guide is an outgrowth of these efforts, involving many steps along the way. When members of the Roundtable called for greater participation from private sector companies in the Roundtable's corporate governance improvement efforts, the Companies Circle was born. A first book of case studies was launched in 2005, with an expanded second edition issued in 2006. Members of the Circle were keen to share experiences and believed a wider audience of Latin businesspeople would benefit from a practical guide exploring the ways and whys of their governance improvements.

***Practical Guide to Corporate Governance: Experiences from the Latin America Companies Circle*** offers an opportunity for business leaders in Latin America to learn from the experience of peers who have successfully implemented substantive improvements in governance standards and practices. It provides rare access to top executives, shareholders and

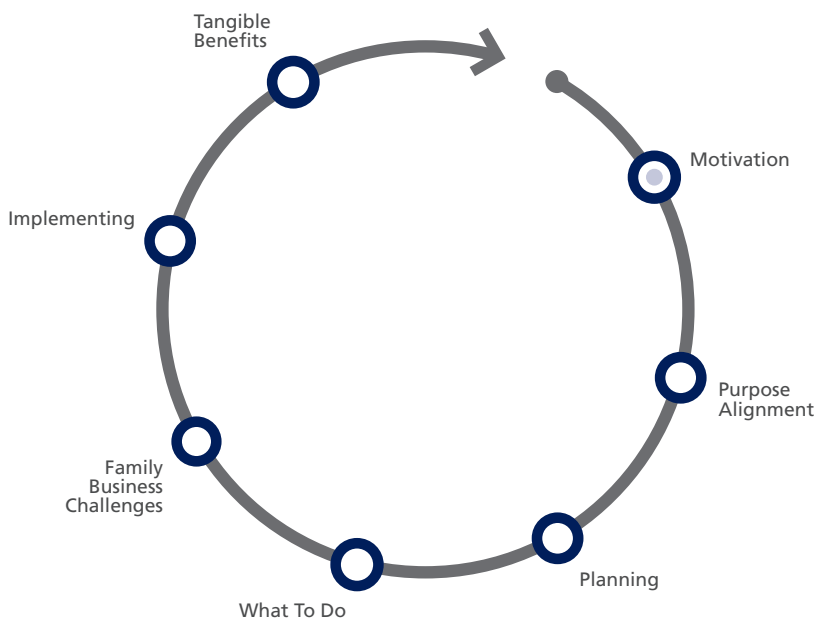
board directors of pioneers in the governance implementation in Latin America. These companies include: Atlas of Costa Rica, Argos and ISA of Colombia, Buenaventura and Ferreyros of Peru, Homex of Mexico and CCR, CPFL, Embraer, Marcopolo, Natura, NET, Suzano and Ultrapar of Brazil.

The guide is unique in bringing together four different dimensions: cases from companies themselves, results of market and academic studies providing supporting evidence of the benefits of governance, best practice standards from institutional references, including IFC, OECD and the Global Corporate Governance Forum, and empirical evidence comparing Circle members' results to their Latin American peers.

The practical nature of the book stems from the real-life experiences of leaders, who talk about why and how they implemented corporate governance policies and practices. The guide offers readers an unusual level of access to a wide range of stakeholders who affect and are affected by governance: from shareholders to board directors to key managers. Rich, first-person testimony is integral to the book, as experienced leaders share motivations, thought processes and experiences, and offer practical solutions that have been tried and tested and can be implemented.

The same range of interested parties that provided information stand to gain most from this guide, particularly listed companies or firms that are actively considering a listing and want to understand the depth and range of impact from profound governance changes. The guide also will prove beneficial to managers and owners of privately-held corporations who are interested in deepening their knowledge of best practice and in drawing on the experiences of leaders who have chosen this path. The family-owned business, which is so predominant and relevant in Latin American markets, fits this category.

Structured over seven chapters, the guide re-creates the journey that business leaders make when implementing change. The guide starts with motivations and ends with benefits, helping the reader navigate logically through the governance implementation process. Some readers may wish to start with later chapters first—the tangible benefits section at the end may be useful in defining motivations—or they may want to dip into various chapters. The approach of each individual reader will vary according to his/her motivations and interests.



## **Chapter 1 Motivation: The Whys Define the Ways**

This chapter introduces the motivations underlying the decisions by leaders of the 14 Latin American Companies Circle member firms to implement governance changes and explores ways leaders might seek to define motivations for implementing good governance. It shows the importance of identifying clearly desired benefits and working to achieve them, while demonstrating the variety of possible motivations, with differences dictated by ownership structure, the life cycle of the company, its industry sector, and the institutional and regulatory framework of the country. All of these elements will play a role, and will impact a company's desired outcomes. The chapter underscores the fact that motivation for governance improvements will drive the agenda and pace of actions.

## **Chapter 2 Purpose Alignment: Changing Attitudes and Generating Commitment**

This chapter examines ways to bring together the varying interests of individual shareholders and stakeholders under one proposed governance change framework. It explores ways to build common understanding on aspects of governance, to spur changes in attitude and to generate commitments from diverse groups of individuals with differing viewpoints. The chapter also addresses dissenting voices and discusses sensitive approaches to changing attitudes associated with beliefs and sometimes conflicting cultural viewpoints. It offers suggestions for reaching out to stakeholders and methods for including all of these various parties.

## **Chapter 3 Planning and Setting Priorities**

Chapter 3 details the planning process, how to prioritize and set key goals, and how to define aims by identifying the desired outcomes from governance. It highlights the importance of balancing several short-term, highly achievable aims with deeper, longer-term change, and measuring the benefits of each. The chapter highlights ways that change leaders can make use of local and international benchmarking to establish an achievable plan with clearly defined responsibilities and timeline: a “roadmap” supported by a rewards and incentives system. The chapter also emphasizes the importance of flexibility and creating realistic expectations for the timetable of change—leaders need to recognize that even the best-laid plans may experience some delays.

## **Chapter 4 What to Do: Key Good Governance Practices**

This chapter provides practical examples on the implementation and execution of plans and best practices. It covers governance mechanisms—the annual general meeting, the board and its committees, management—and the relations among them. Practices and policies are described, drawing upon the Circle members' rich experience.

The governance improvements are grouped and presented in six sections:

- › Formalizing governance policies: codes and guidelines
- › Functioning of the board of directors and relations with executive management
- › Strengthening of shareholders' rights and maintaining alignment
- › Improving the control environment
- › Transparency and disclosure of information
- › Ensuring the sustainability of the business

## **Chapter 5 Governance Challenges for Family-Owned Businesses**

Chapter 5 looks at the specific benefits and challenges faced by family-owned businesses. It presents various perspectives, including those of family members and investors, and introduces academic research on the topic. This chapter investigates the most common problems, including managing conflicts of interests of various family members, professionalizing management, and institutionalizing good practice and policies. It incorporates a business case from a third-generation, family-controlled company, showing how members resolved these issues.

## **Chapter 6 Implementing Governance**

This chapter details the specifics of implementing policies, practices and new structures. It includes advice on how to take the first concrete steps on the corporate governance journey, monitor results and ensure that they are aligned with initial expectations. The chapter also suggests ways to fine-tune governance policies to make them responsive to reactions from shareholders and other stakeholders. The material covers initial actions as well as monitoring and continuous revision of the governance process to achieve best results and to continue learning and improving, a process dubbed “governing governance.”

## **Chapter 7 The Tangible Benefits of Good Governance**

Chapter 7 provides the bottom line on governance: a series of quantitative results using five different approaches to evaluate the benefits of corporate governance across a broad range of indicators. The analysis focuses on the impact of governance on operational indicators and on the cost of capital. These data reinforce the view that governance yields benefits. The data demonstrate the strength of financial and operational results achieved by governance leaders when compared to all Latin American listed companies.

Companies Circle members reported higher levels of profitability, share prices and liquidity, and lower cost of capital than their Latin American counterparts. Additionally, in the short term, public announcements of governance improvements were followed by an immediate 8 percent average increase in share value beyond what would normally have been expected. For shareholders, the analysis underscores the benefits of investing in companies with strong corporate governance policies.

This chapter also takes a first look at the impact of the crisis on corporate governance results during the second half of 2008, again comparing the Circle group with all Latin American listed companies. The results presented show that even after the first reactions to the financial turmoil, Circle members registered better market and operational results. Of even greater significance, the analysis showed that the Circle group enhanced its lead for price/earnings ratios and share price/book value ratio when compared to 2005-2007 results. Clearly, investors have perceived that Circle companies offer better value than the broader Latin American group in a time of market distress.

The chapter also details the stock market reaction during this period. The results show that the declines were not as steep for Circle group stocks. Given that this outcome could be attributed to other factors, another test using a more complex methodology and putting aside other corporate attributes was applied. Once again, the results offer a clear sign that being part of the Circle group and/or cross-listing in a stricter market are factors that soften stock declines during market stress.

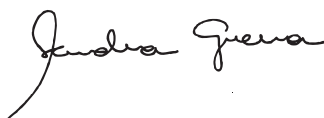
These qualitative and quantitative results are particularly timely, coming at a time when many companies are struggling with what may prove to be the worst economic downturn in generations and when they may be tempted to shelve their governance plans.

In the appendices to the guide, there are tools to help companies start their corporate governance journey. A 100-point benchmarking questionnaire, designed for listed companies, provides a reference for self-evaluating corporate governance practices. The IFC Corporate Governance Progression Matrix is another helpful tool for listed companies. Both may be of use in structuring an initial assessment of governance practices. Additional references to other sources are provided along with a glossary of terms to help navigate through concepts and definitions.

In an era that promises to be more competitive for financing and investor attention, this book is a useful reminder that governance is of vital importance for sustainable growth and creation of value for all actors in the governance chain: shareholders, managers, board directors, investors and all other stakeholders who contribute to the wealth creation of companies. The book is designed to serve as a practical guide for those companies keen to embark on the governance voyage.

All that remains is to welcome readers to the journey with hopes that this guide will provide food for thought and lead to rewarding places.

Sandra Guerra

A handwritten signature in black ink, reading "Sandra Guerra". The signature is fluid and cursive, with the first name "Sandra" and last name "Guerra" clearly distinguishable.

Companies Circle of the Latin American Corporate Governance Roundtable  
Coordinator