

# Latin American Corporate Governance - The OECD Perspective

by

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Hemispheric Trade Conference

LSU Law Center

April 26, 2006

# I. Introduction

# Getting Started

- **Definitional Issues**
- **Published in 2003**
- **Key Contributors**
  - **OECD**
  - **World Bank**
  - **International Finance Corporation (IFC)**
  - **Key Regional Figures From Public and Private Sector**

## Overview

- **Importance of Good Corporate Governance for Latin America**
- **Regional Characteristics**
- **Reform Priorities**
- **Recommendations**

## **II. Importance of Good Corporate Governance for Latin America**

## Importance of Private Sector

- Latin American countries increasingly depend on private sector for job creation, generation of tax revenue, and furnishing of goods and services.
  - Recent changes in region's political makeup notwithstanding.
- Latin American economies need local companies that have access to lower capital costs and that adopt sound management and corporate governance practices.

# Role of Private Pension Systems

- Reform of public and private pension systems in region
  - Shift to privately managed funds investing in publicly traded companies.
  - Assuring transparency and accountability by publicly traded companies benefits private pension funds and its retirees.
  - Private pension system is one of the most important reasons why corporate governance must improve.

## Effect on Entire Economy

- Enhances necessary elements of developed economy
  - Strong capital markets
  - Banking system
  - Private equity/venture capital
  - Mutual funds
  - Insurance
- Advances internalization of capital markets
  - Limits economic volatility/enhances stability
  - Attracts much needed foreign investment to countries in the region

## Relevance for Private Companies

- OECD report focuses on publicly traded companies and private companies with potential in short-term to go public.
- But even non-listed companies (often founder-owned or family-owned) will need to adopt sound accounting practices and appropriate checks and balances in management to remain competitive

# Types of Reforms

Types of corporate governance reforms:

1. Rights of shareholders
2. Equitable treatment of shareholders
3. Role of stakeholders in corporate governance
4. Disclosure and transparency
5. Responsibilities of the Board
6. Improving compliance and effective enforcement

# Fighting Corruption

- Improving disclosure, transparency, and accountability advances desired goal of controlling public corruption.
- Checks and balances within the corporation, proper oversight of executive management by the board, better internal controls, and clear lines of accountability reduce opportunity for company representative to involve company in public corruption.

# III. Regional Characteristics

# Key Shared Regional Characteristics

## Privatization

- Private sector provides most of society's goods and services
- Positive effect on democracy

## Concentration of ownership, defined control, and need for capital

- Families often hold controlling stakes
- Challenge is to tap international sources of capital, satisfy outside investors, and not sacrifice alignments of interests of ownership and management

## Importance of industrial groups

- Common control and ownership of large firms
- Historically functioned as substitute for absence of developed capital markets
- However, groups can stunt access to capital markets for others.

## Restructuring of banking systems

- State ownership has declined
- International banks replace domestic institutions
  - Rise of more specialized institutions

## Regionalization, internalization, and importance of multinational enterprises

- New round of economic integration in region
  - NAFTA, Mercosur, etc. are important realities

## Limited domestic capital markets and growing importance of foreign listings

- Shrinkage in local markets
- ADRs
  - Foreign issuers explicitly included within Sarbanes Oxley
- London AIM growing in popularity as response to Sarbanes Oxley

## Mandatory privately managed pension schemes

- Private pension plans have important influence

## Legal traditions and enforcement patterns

- European civil code tradition
- Also approach to law enforcement and contract enforcement

# IV. Reform Priorities

- Taking voting rights seriously
  - Facilitate and encourage shareholder participation at annual meetings
  - Institutional investors should behave in a more active and informed manner
- Treating shareholders fairly during changes in corporate control and de-listings

- Ensure integrity of financial reporting and improve disclosure of related party transactions
  - National accounting standards should be brought into compliance with International Financial Reporting Standards
  - Elimination of conflicts of interest
  - Disclosure of related party transactions and potential conflicts of interests should also be improved
  - Disclosure of corporate ownerships and control structures

- Developing effective boards of directors
  - All directors should act independently in interests of company and all shareholders
  - Greater specificity concerning procedural steps for fulfillment of director's duty of care and loyalty
  - Boards should more clearly define work procedures
    - Special board committees
  - Boards should improve their ability to manage conflicts and ensure compliance with laws and ethical standards

- Improving quality, effectiveness, and predictability of legal and regulatory framework
  - Availability of private actions, class actions, alternative dispute resolutions, etc.
- All proposed reforms should be assessed to avoid unintended effects and unduly hampering economic activity.



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