Why should Brazil Attract More Foreign Investors Than Other BRIC Countries?

The main argument of this essay is to investigate the corporate governance practices of BRIC countries to show why Brazil is best country attract and maintain foreign investors in the long term.

In the first part BRIC companies will be compared the in terms of their unique problems and four general corporate governance topics which are;

- Shareholder's right and investor relations
- Financial transparency and information disclosure
- Board and management structure and process
- Corruption in the corporate governance

And finally, in the last part conclusion.

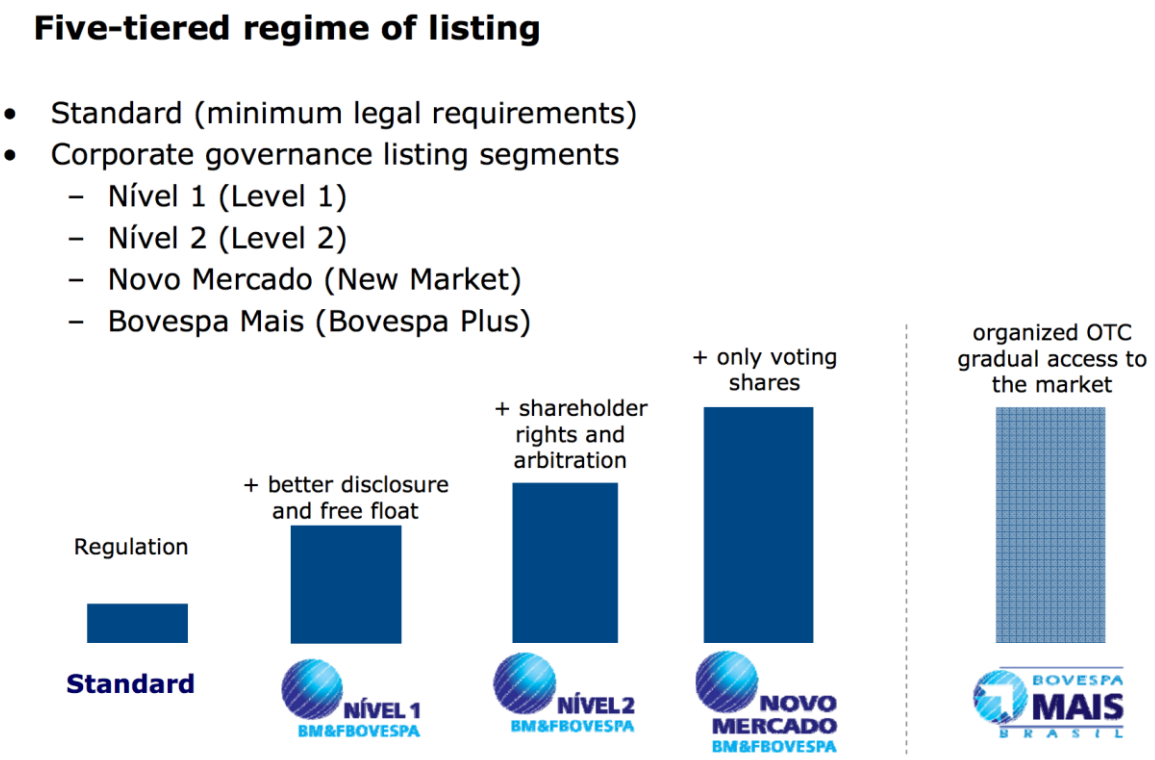
Brazil

Brazil has come a long way in its journey with corporate governance in the last two decades. Private companies were associated with most of the share trading activities. In 1990s corporate governance laws have failed to protect the rights of the minority shareholders by offering only limited protection (Salama, Prado 2011). Thanks to Introduction new listing systems by Bovespa, in 2000, called Level 1, level 2 and Novo Mercado, corporate governance was much more safe and solid than ever before. Governance rules were improved significantly and group of voluntary listings levels were created.

There are relatively weak and strong points in corporate governance of Brazil for foreign investors to keep an eye for. One of the major weakness is the lack of stability in the board of directors. While the common corporate governance concern is that boards can be too large to be effective, in Brazil, in contrast, it seems like most of the boards are too small to be effective and because of its size it will have a limited range of expertise and cannot effectively delegate some of their works to committees (Black et al, 2009). These boards consist of a group or a family or comprised entirely of insiders. Most of the firms in Brazil does not have independent board member. However, Novo Mercado required firms with at least 5 members being %20 of directors to be independent (Black et al, 2014)

Financial reporting and disclosure were another issue with the Brazil's corporate governance. English disclosure was only made by voluntary companies and because of there was no existing law, there were no cash flow statements or consolidated quarterly financial statements. However, Bovespa requires companies to provide higher financial reporting standards such as IFRS or U.S. GAAP (Black et al, 2009). With these regulations, Brazil had started to get its corporate governance stronger and showed why it is a potential emerging market. Another strong point for Brazilian firms is cross-listing. As a signal to enhance their corporate governance practices, firms in Brazil took opportunity of cross-listed shares that showed companies will follow and abide by the corporate governance rules adopted by the well-developed stock market (Ibrahim and Youssef, 2013)

In many companies in Brazil the voting shares were kept inside of the company and only non-voting preferred shares were being publicly buyable which gives almost all the right to vote to insiders. Novo Mercado required firms to only issue voting shares and have a free float of %25 of these shares (Gouvèa, 2013). Also put procedures on public offerings to enhance the dispersion of the company shares (Holanda, 2010). This means that companies cannot have different classes of shares. This system change gave shareholders much more protection and confidence in decision making process of their investment.



Novo Mercado Stock Exchange listings (Holanda, 2010)

Corruption is one of weaknesses of Brazil's corporate governance system that makes investors hesitate to do business in Brazil. Petrobras and Odebrecht names were flashing all around the world-wide new outlets for huge corruption news. According to Transparency.org (2016) Corruption Perception Index, Brazil was ranked 79th, with score of 40 out of 100 in transparency, out of 176 countries. Brazil is signatory to the OECD Anti Bribery and participating member of the OECD Working Group on bribery. Even though Brazil has laws, regulations and penalties to fight with corruption but their effectiveness is inconsistent (ICS, 2015a). The Clean Company Act in Brazil holds companies responsible for the corrupts acts of their employees and introduces strict liability for those offences (GAN Integrity, 2015). In World Bank's Doing business report, (2017a), Brazil was ranked 123rd out of 190 countries declining by two places from 2016. In the light of these numbers and facts, it is clear that in Brazil's opportunity is rising with strong regulations on legislation, public procurement and corporate governance in its way to convince foreign investors to visit country more often.

Topics	DB 2017 Rank	DB 2016 Rank	Change in Rank	DB 2017 DTF (% points)	DB 2016 DTF (% points)	Change in DTF (% points)
Overall	123	121	↓ 2	56.53	56.60	↓ 0.07
Starting a Business ✔	175	174	↓ 1	65.04	64.20	↑ 0.84
Dealing with Construction Permits	172	170	↓ 2	51.28	51.27	↑ 0.01
Getting Electricity	47	39	↓ 8	81.23	82.32	↓ 1.09
Registering Property	128	130	↑ 2	52.62	52.64	↓ 0.02
Getting Credit	101	97	↓ 4	45.00	45.00	-
Protecting Minority Investors	32	30	↓ 2	65.00	65.00	-
Paying Taxes	181	181	-	33.03	33.12	↓ 0.09
Trading across Borders ✔	149	150	↑ 1	55.57	54.20	↑ 1.37
Enforcing Contracts ✔	37	45	↑ 8	67.41	65.55	↑ 1.86
Resolving Insolvency	67	60	↓ 7	49.15	52.68	↓ 3.53

✔= Doing Business reform making it easier to do business. ✗ = Change making it more difficult to do business.

Brazil Doing Business Scores (World Bank, 2017a)

Russia

The Russian Federation has a highly centralized, authoritarian political system dominated by President Vladimir Putin. In Russia, government has huge impact on corporate governance apart from the rules and regulations set. But even with obstructions from the government to the corporate governance in informal ways, Russian laws on governing companies and regulations has improved significantly, on the paper.

Country's corporate governance laws were constructed from the scratch in the late 1980s. These laws continued by legalization of private companies in 1986, Law on Property in 1991 and Law of Privatization of State Enterprises in 1992, Joint Stock Company Law strengthening shareholder rights in 1996 covering the stronger laws and providing enhanced protection of minority shareholders (Estrin and Prevezer, 2011). McCarthy, Puffer and Shekshnia (2004) point out that even though corporate governance system recognizes the inherent problem about the protection of shareholders, problems in taking action were still there because of negligent application of laws on protecting shareholder's rights and a big opaqueness over company regulations and bankruptcy. In the following years, many laws have been introduced and adjusted to improve transparency in the company's financial profile, minority shareholder rights were strengthened and judiciary system was improved. But again, these improvements made just for the books and Russia had tough times to put these into action.

Corruption in Russia is one of the major problem that country lack international investor. The blat tradition is a part of life. In the judicial system, even though the law provides for an independent judiciary, judges are subject to undue influence from politicians, the executive branch, the military and the executive forces (GAN Integrity, 2017a). U.S. Human Right Practices Report for Russia (2016a) stated that;

"The law provides criminal penalties for official corruption, but the government acknowledged difficulty enforcing the law effectively, and officials often engaged in corrupt practices with impunity. In March 2015, the government passed a law reducing ceiling on fines for receiving and providing a bribe"

The political leadership in Russia often sacrifices its own rule of laws, civil and human rights to reinforce its own political power, especially on people and companies (Yukos) who challenge authority of the government, because the country's leaders believe is a must to maintain a stable power in governance. As a result of corruption courts on the rural areas and on the lower level act biased by the pressure from the local authorities. (BTI, 2016a). Also, government agencies have taken actions against independent reporters which resulted in murder and imprison (Qui, 2016). According to CPI (2016) Russia, scoring 29 out of 100, is ranked 131st out of 176 country. From the corruption and free press perspective

Russia fails to obtain a stable standard and keeps failing in name of protecting and maintaining the government's interests.

According to (2015b) United States investment climate report of Russia, foreign firms which thinking of investing into Russia should be ready to face the high levels of uncertainty, corruption, and political risk, making thorough due diligence and good legal counsel essential for any potential investment. Regulations states that, investing into strategic sectors listed by Russian Government requires for foreign investors to take approval from the government and in some cases, ownership can be taken from the foreign investment company. For example; In media sector, with the law passed on 2014, foreign ownership cannot be more than %20 in any media outlet.

Foreign investors have had problems with limited protection for minority shareholder and corporate governance in terms of disclosures even though by law firms in the stock exchange are required to disclose specific information during the placement process and on a quarterly basis. (ICS, 2015b). Regarded as high compliance country, Russian Federation is working towards to meet the international standards for corporate governance, indicating a sound legal framework in line with OECD principles (Estrin and Prevezer, 2011), IFRS and US GAAP. However, transparency in firm disclosure remains as a huge problem for foreign investors in Russia.

Topics	DB 2017 Rank	DB 2016 Rank	Change in Rank	DB 2017 DTF (% points)	DB 2016 DTF (% points)	Change in DTF (% points)
Overall	40	36	↓ 4	73.19	73.20	↓ 0.01
Starting a Business	26	37	↑ 11	93.57	92.35	↑ 1.22
Dealing with Construction Permits ✔	115	117	↑ 2	65.86	64.67	↑ 1.19
Getting Electricity	30	26	↓ 4	84.37	84.22	↑ 0.15
Registering Property	9	8	↓ 1	90.55	90.51	↑ 0.04
Getting Credit	44	42	↓ 2	65.00	65.00	-
Protecting Minority Investors	53	51	↓ 2	60.00	60.00	-
Paying Taxes	45	40	↓ 5	82.96	83.09	↓ 0.13
Trading across Borders	140	138	↓ 2	57.96	57.96	-
Enforcing Contracts ✗	12	8	↓ 4	74.96	75.78	↓ 0.82
Resolving Insolvency	51	49	↓ 2	56.69	58.39	↓ 1.70

✔= Doing Business reform making it easier to do business. ✗ = Change making it more difficult to do business.

Russia Doing Business Report Scores.
(Word Bank, 2017b)

India

India is federal public and has parliamentary democracy which operate under the constitution of 1950 with 29 territories and seven union territories (CommonWealth, 2017). In the economic field the focus of government was on growth on and promotion of foreign direct investment to specific sectors such as opening of additional sectors for foreign investment (BTI, 2016b). The BJP Government led by Narendra Modi had taken many steps to encourage foreign investors to come into India by simplifying the regulations and restrictions on insurance, medical services, railways, construction and defence. Even though Indian government's steps are a good sign for attracting foreign investors into the country, there are some uneven parts of Indian corporate governance policies and acts. For example, the Insurance Act established in 2015, raises caps on FDI from 26 percent to 49 percent but mandates insurance companies to retain Indian management and control, also many sectors that stays out of the ones mentioned above requires foreign investors to apply for multi-step process for central and state government approval (ICS, 2015c).

Related party transactions in India has been a big issue after several big companies founded to be acting improprietly on. A study made by Srinivasan in 2013 revealed that companies with high RPTs related to sales and income were found to report lower performance than companies with low RPTs and ownership structure failed to offer any explanation for the magnitude of RPTs. It is an issue that with faulty RPTs, minority shareholder's rights are being purposely overlooked.

Like other BRICs countries there are laws and regulations to protect the shareholders and creditors in India but corporate governance bodies struggle in terms of how effective the law is enforced. This may be because of ownership and management of firms commonly belongs to families in India. Although the legal laws for shareholders is very well constructed, enforcements on protection of shareholders' right changes from region to region in India with some having effective legal rights and in others for example Bihar the law is not applied as it should be (Estrin and Prevezer, 2011). U.S. Investment Climate Statement (2015) for India indicates that;

"Investors who planning to invest into India should be prepared for varied political and economic conditions across the counrty. There are differences in the quality of governance, regulation, taxation and education levels. Its courts have cases backlogged for years, and by some accounts more than 30 million cases could be pending at the various levels of the judiciary"

In 2013 with help from OECD, Indian Company Act has introduced innovative measures which increases shareholder involvement in decision making and introduce transparency in the corporate governance, which increases protection the shareholders. A few important improvements made by Company Act 2013 are (McRitchie, 2015);

- Independent directors are a newly introduced concept under the Act

- Every company must make accurate disclosure of financial situations, ownership and governance
- Top management recognises the rights of the shareholders.

India has a big and wide landscape, therefore not all shareholders able to attend to meetings so they send agents as proxies. But Indian laws does not give proxies right to speak and tell the opinion of the legal shareholder in the shareholder meetings and in the voting process by law proxies are permitted to vote by show of hands but there is no practice to give this permission to proxy (Kothari, 2015). In one of his interview Chairman of SEBI Ayar Tyaqi stated that "There are serious concerns about the standard of corporate governance which means India is lacking code of conduct for investors" (IANS, 2017).

There is a high risk of corruption for companies which are thinking of investing to India. Even though government has taken actions against corruption with Prevention of Corruption Act in public sector and with Companies Act in private, bribery and red tape is very widespread in the judiciary, police, public services and public procurement sectors due to low levels of track and exercise (GAN Integrity, 2017b). According to (2016b) Human Rights Report for India government set restrictions on NGOs to get fund from foreign investors, including those government believed to be not in the "national or public interest". In Corruption Perception Index (2016) India is ranked 79th out of 176 country.

Topics	DB 2017 Rank	DB 2016 Rank	Change in Rank	DB 2017 DTF (% points)	DB 2016 DTF (% points)	Change in DTF (% points)
Overall	130	131	↑ 1	55.27	53.93	↑ 1.34
Starting a Business	155	151	↓ 4	74.31	73.74	↑ 0.57
Dealing with Construction Permits	185	184	↓ 1	32.83	32.83	-
Getting Electricity ✔	26	51	↑ 25	85.09	79.76	↑ 5.33
Registering Property	138	140	↑ 2	50.00	49.97	↑ 0.03
Getting Credit	44	42	↓ 2	65.00	65.00	-
Protecting Minority Investors	13	10	↓ 3	73.33	73.33	-
Paying Taxes ✔	172	172	-	46.58	43.17	↑ 3.41
Trading across Borders ✔	143	144	↑ 1	57.61	56.45	↑ 1.16
Enforcing Contracts ✔	172	178	↑ 6	35.19	32.41	↑ 2.78
Resolving Insolvency	136	135	↓ 1	32.75	32.59	↑ 0.16

✔= Doing Business reform making it easier to do business. ✗ = Change making it more difficult to do business.

China Doing Business Report Scores (World Bank, 2017c)

China

The People's Republic of China is governed by Chinese Communist Party (CCP). Members of CCP holds and controls all the top important positions in the government authorities. In all the BRIC countries, China may be the worst one to accept and govern the foreign direct investment because it is stated that foreign investors face limitation to many markets, problems in finding human resources, vague and inconsistent enforcements of laws and regulations as significant challenges to invest and run a business. Also, concerns have been raised for China's corporate governance practices about discriminatory industrial policies, not fully transparently made and selectively enforced investment approval process, many barriers to protect domestic companies and biased and ineffective judiciary system if contracts are disobeyed (ICS, 2015d)

The one of the biggest problem for Chinese corporate governance is the concentration of state ownership that holds up to two-third companies listed in the SSE are under the state ownership which lacks the efficiency in capital allocation. Also, a long-coming problem, Chinese companies' false financial disclosures (Kang, Shi and Brown 2008). The annual statistics disclosed by the antitrust agencies since 2008 are opaque and incomplete. (The Economist, 2014)

In Transperancy.org's Corruption Index (2016) China is ranked 79th out of 176. Anti-corruption reporting website GAN Integrity (2016) stated that, in the business area foreign investors are likely to face corruption in China by a common practice of *guanxi* which is a custom for building relationships in business area by giving gifts to related party and added "China has legal frameworks for both public and private sector to avoid corruption but they are inconsistently and selectively applied."

Minatory shareholder rights are also exploited by controlling shareholders in the companies. Ying and Wang (2013) argue that in China, controlling shareholders exploit minority shareholder's rights through occupying or shifting funds, corrupted related-party transactions or by selling company's assets and products below the market price to companies which they prefer close relationships. It is kind of a tradition in the structure that ownership of listed Chinese firms is highly central and concentrated. In their research, Wang and Xiao (2011) stated that private benefits by tunneling by controlling shareholders in China is very large and government lacking to enforce the legal corporate governance rules to protect minatory shareholder's interests. These insider trading problems remains as a huge gap for foreign investors to even think about investing into China.

Government interference in all parts of legal system is very observable. Only a few sectors open for foreign investors and many of them are restricted by the Government. At the top firms CCP is the decision maker when it comes to filling the top positions. It is hard to say that financial press is free to report corporate governance problems. It is reported by the Human Rights Report of China (2016c) that government took part in torture, detention and harassment of journalists, lawyers, writers and bloggers and CCP even restricts professors to talk about "independent judiciary system" in the universities.

OECD in 2001 took some actions to contribute to China in terms of improving regulations on corporate governance of listed China firms. China is a member of WTO since 11 December 2001. Government also agreed to adjust the financial reporting according to IFRS.

Topics	DB 2017 Rank	DB 2016 Rank	Change in Rank	DB 2017 DTF (% points)	DB 2016 DTF (% points)	Change in DTF (% points)
Overall	78	80	↑ 2	64.28	62.86	↑ 1.42
Starting a Business ✔	127	134	↑ 7	81.02	77.46	↑ 3.56
Dealing with Construction Permits	177	175	↓ 2	48.52	48.29	↑ 0.23
Getting Electricity	97	92	↓ 5	68.73	68.66	↑ 0.07
Registering Property	42	42	-	76.15	76.15	-
Getting Credit ✔	62	78	↑ 16	60.00	50.00	↑ 10.00
Protecting Minority Investors	123	118	↓ 5	45.00	45.00	-
Paying Taxes	131	127	↓ 4	60.46	60.50	↓ 0.04
Trading across Borders	96	94	↓ 2	69.13	69.13	-
Enforcing Contracts	5	4	↓ 1	77.98	77.98	-
Resolving Insolvency	53	53	-	55.82	55.43	↑ 0.39

✔= Doing Business reform making it easier to do business. ✗ = Change making it more difficult to do business.

China Doing Business Report Scores (World Bank, 2017d)

When BRIC countries are compared from the certain perspectives, such as free press, government interference, corruption and shareholder rights, it is seen Brazil takes the top. The reason for that, for example in Russia and China, governments have ultimate control over from judiciary system to sectors that companies can invest and there is no permission to challenge the authority of the government. However, in Brazil, it is clearly seen that even the top-positioned government personals are sentenced to prison because of corruption. There is a free financial press in Brazil which is one of the most important aspects to know about problems in the corporate governance. Unfortunately, human rights reports for Russia and China has been criticizing them for their impudent acts on press and journalists. In Russia and China government interference into judiciary system is very high. In India Judiciary system, normal working process seems to be defective. Brazil stays innocent beside what other BRIC countries accomplish with government interference, free press, pushing corruption and stable working judiciary system.

Even if India has taken important steps to increase its protection for minatory shareholders there are still problems in enforcing these protections. Opaque related-party

Transactions and multi-step approval process for foreign investors is another headache for India. All of BRIC countries have laws and regulations about protecting shareholder's rights from highly concentrated central ownerships and avoiding corruption but Brazil slightly steps up in terms of enforcing these laws and puts legal framework into action.

There is a strong opinion about Brazil, in some ways, outclasses the other BRICs, unlike China, it is a democracy, unlike India it has no insurgents, no ethnic and religious conflicts not hostile neighbours. Unlike Russia, it exports more than oil and arms and treats foreign investors with respect (The Economist, 2009).

Overall, If the improvements on corporate governance and overall financial disclosures continue in Brazil, it will be the best route for foreign investors to look for in BRIC countries.

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