

The Role of the BNDES (Brazilian Development Bank) on the Corporate Governance of Large Companies in Brazil

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Abstract

The Brazilian Development Bank (BNDES) is the main financing agent for long term investments in Brazil. Given its relevance, deriving from its large disbursements at subsidized interest rates, the bank could positively influence the corporate governance landscape among large Brazilian companies. This essay qualitatively analyzes the hypothesis that BNDES promotes higher governance standards in its investee companies, by focusing on the 2009 operations of the bank. The results do not support this view. The analysis of both BNDES loans and investments as shareholder and bondholder does not corroborate the argument that the bank requires higher corporate governance standards when makes its investments, nor that it promotes it afterwards. On the contrary, anecdotal evidence is found of companies with recent corporate governance problems that have received large inflows from the bank, as well as of several companies extremely opaque in their governance model which are among the main loan operations of the bank in 2009. The essay also proposes some measures that BNDES could adopt in order to explicitly take into account governance issues in its disbursements decisions. Such measures could encourage firms to invest more in better governance practices, as well as convince the market that corporate governance is a key issue for BNDES.

Key-words: Corporate Governance, BNDES, Brazil, BRIC, State Capitalism.

JEL classification: G30, G32.

Since its inception in 1952, the Brazilian Development Bank (BNDES) has been the main source of capital for long term investments in the Brazilian corporate environment¹. The bank has many unquestionable merits during its trajectory. Recently, it was one of the main agents responsible for the maintenance and expansion of the credit in the subsequent months following the global financial crisis initiated in September 2008. According to the own institution's calculations, the BNDES has contributed with 36% of the increase in financing operations during that period. Still according to the bank, its operations also enabled the maintenance and/or creation of over 3 million jobs in 2009.

The bank displays impressive numbers. In 2009, it disbursed R\$ 137.4 billion (around US\$ 77 billion), three times more than the total sum spent by the Inter-American Development Bank (IDB) and the International Finance Corporation (IFC) – a branch of the World Bank – which together disbursed US\$ 25 billion in 2009. BNDES's total assets, adding up to R\$ 386 billion (around US\$ 217 billion), are approximately twice as much as the total amount held by IDB (US\$ 84 billion) and the IFC (US\$ 51 billion). In fact, this figure puts it closer to the International Monetary Fund (IMF, with about US\$ 340 billion in assets) than to these institutions.

Such gigantism raises two main questionings: the economic fairness of the money spent, and the BNDES's impact on the governance quality of its invested companies.

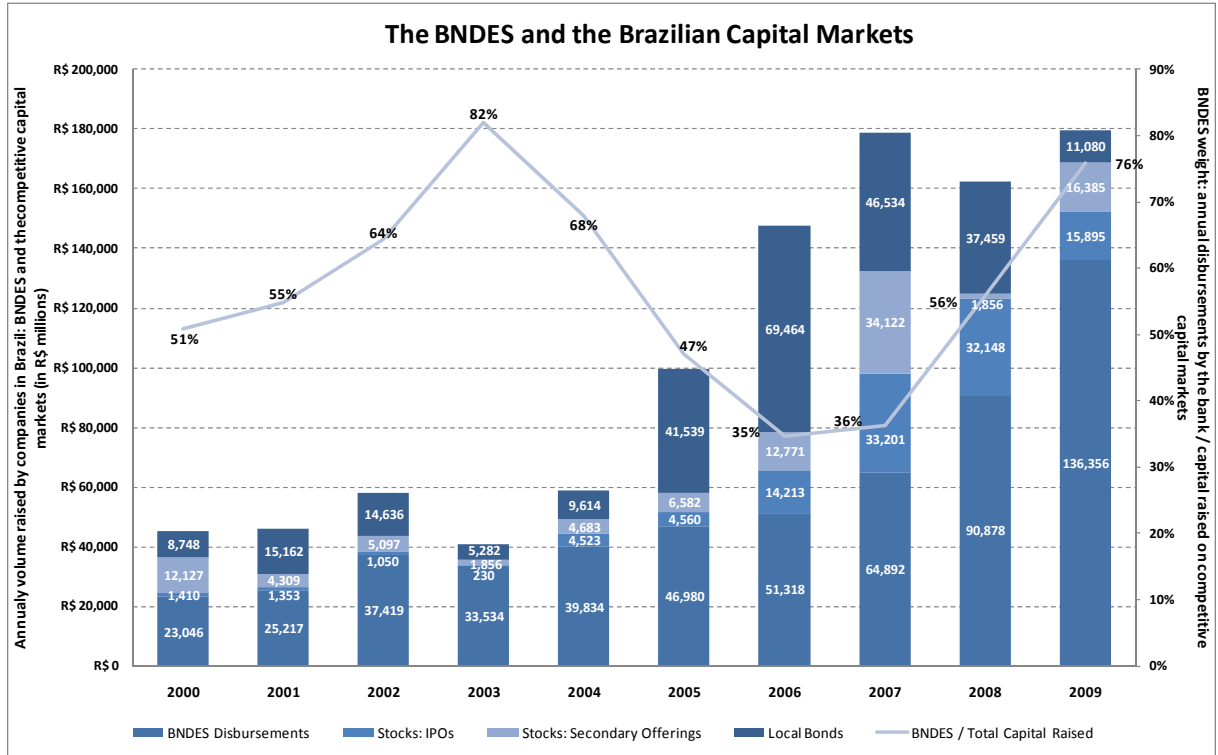
Regarding the first issue, the BNDES lends resources at a cost that is mainly subsidized by taxpayers (using funds from the National Treasury) and through workers (using the Workers' Support Fund, a compulsory contribution paid by all registered workers — FAT). In 2009, for example, the government lent R\$ 100 billion to the bank to be repaid by applying the so-called “Long-Term Interest Rate” (TJLP), an interest rate lower than Selic (the official rate set by the Central Bank which is paid by the government to finance its public debt). On the other hand, large companies – usually the ones with better credit risk and higher

probability of raising funds through the market – are the main beneficiaries of these funds. According to BNDES, 83% of its outlays in 2009 were directed to large companies. The fact that these companies' financing was subsidized mostly by low-income workers even drew the attention of the magazine *The Economist's* in its report on Brazil in late 2009. At that time, the publication criticized the initiative, calling it “a bizarre appropriation of public resources that would cause an outcry in other countries”².

The second issue deals with the potential impact of BNDES on the corporate governance practices of the large companies it invests in. This is the focus of this essay. Conceptually, the bank may act as "doubled-edged sword" regarding this issue. On the one hand, its power and influence could induce companies to adopt the highest corporate governance standards, with positive impacts for other investors and for the market in general. On the other hand, the abundant supply of financial resources at low cost without any governance requirements or explicit consideration of this issue could discourage companies from improving their practices as a way of competing for resources.

The chart below evidences the BNDES's significance for the Brazilian financial markets. The bars indicate the source of the long term funds raised in the Brazilian market from 2000 to 2009. The line reveals the percentage of long term funds stemming from the BNDES against the fund raised by companies in the competitive capital markets. As shown in the chart, after a trajectory of relative descending weight starting in 2003, the BNDES became once again to be the main source of long term funding in 2008, representing almost three quarters of the total long term capital raised by companies in 2009.

Chart 1 – BNDES relevance on the total long term financing in Brazil.



Sources: BNDES managerial reports and CVM reports (Brazilian Securities and Exchange Commission).

So far, there are no academic studies clearly indicating any positive impacts of the BNDES on corporate governance practices in Brazil. However, an analysis of its public information regarding its recent credit and stockholding operations does not suggest that the bank has been an effective inducer of higher corporate governance standards.

Regarding its credit operations, there is no mention in the institution's reports about the weight, if any, given to corporate governance aspects in its decisions to approve loans to large companies. Therefore, the bank does not clearly say how important the adoption of best corporate governance practices are for the approval of its credit operations, nor states which governance practices are taken into account when it analyzes its loan requests. From the companies' point of view, it's not clear how much is worth to be invested in better governance practices, nor which practices could increase the probability of being well evaluated and having its loan requests approved.

The table below displays the bank's top 30 loan operations in 2009, which alone totaled about R\$68 billion (about US\$ 38 billion) disbursed by BNDES over the period.

Table 1 – Largest BNDES corporate loans in 2009.

#	Company	Area	BNDES disbursement (R\$ Million)	Listed on Stockmarket?	Listed on Novo Mercado?	% Independent BoD members	Audit Committee?
1	Refinaria Abreu e Lima	Commodities	9,890	-	-	NA	NA
2	Petrobras	Commodities	9,410	YES	-	22%	NO
3	Energia Sustentável do Brasil	Infrastructure	7,220	-	-	NA	NA
4	Santo Antonio Energia	Infrastructure	6,135	-	-	NA	NA
5	Transportadora Associada de Gás - TAG	Commodities	5,700	-	-	NA	NA
6	JBS	Industry	3,480	YES	YES	14%	NO
7	Telemar Norte Leste SA	Infrastructure	3,464	YES	-	11%	NO
8	ALL Logística	Infrastructure	2,718	-	-	17%	YES
9	Cia Petroquímica Pernambuco - Petroq. Suape	Commodities	2,010	-	-	NA	NA
12	Grupo Votorantim	Commodities	1,457	-	-	NA	NA
10	Porto do Pecem de Energia	Infrastructure	1,410	-	-	NA	NA
11	LLX Logística	Commodities	1,321	YES	YES	18%	NO
13	Brenco Cia Brasileira de Energia Renovável	Industry	1,151	-	-	0%	NO
14	VALE	Commodities	1,128	YES	-	10%	NO
15	Estaleiro Atlantico Sul	Industry	1,052	-	-	NA	NA
16	Alcoa Alumínio	Commodities	944	-	-	NA	NA
17	Sabesp	Social Inclusion	826	YES	YES	23%	YES
18	Porto de Itaquí Geração de Energia	Infrastructure	798	-	-	NA	NA
19	Brasil Telecom Celular	Infrastructure	766	YES	-	11%	NO
20	BRF Foods	Industry	750	YES	YES	27%	NO
21	Ambev	Industry	710	YES	-	11%	NO
22	COMGAS	Commodities	665	YES	-	0%	NO
23	Fibria Celulose	Commodities	661	YES	-	22%	YES
24	Volkswagen do Brasil	Industry	643	-	-	NA	NA
25	COSAN	Industry	636	YES	YES	33%	NO
26	Klabin	Commodities	624	YES	-	8%	NO
27	Brasil Telecom	Infrastructure	623	YES	-	11%	NO
28	STX Brazil Offshore	Commodities	607	-	-	NA	NA
29	Braskem	Commodities	566	YES	-	0%	NO
30	CSN - Cia Siderurgica Nacional	Infrastructure	558	YES	-	43%	YES
		TOTAL	67,922	16	5	16%	4

Fonte: BNDES website (www.bndes.gov.br). Only operations above R\$ 300 million were taken into account.

Table 1 displays a dismal panorama regarding the potential impact of BNDES on highest corporate governance standards. Only 16 out of the 30 companies that received the largest loan operations from the bank are publicly traded (something that tends to increase accountability and market scrutiny), and only five belong to the Novo Mercado, the higher listing segment at BM&FBOVESPA in terms of corporate governance practices. Even among the firms listed on Novo Mercado – in thesis the ones with better practices – some have gained notoriety in the recent years for bad governance, like BFR Foods (a food company with billionaire losses in 2008 due to speculation on derivatives' markets) and Cosan (a huge ethanol and sugar cane producer which attempted a very controversial shareholding reorganization in 2006 against the interests of most of its minority shareholders).

Another analysis reinforces the view that, among the 30 largest loan operations of BNDES in 2009, few companies could be considered “models to be followed” in terms of corporate governance practices. Earlier in June 2009, I have investigated the websites of these companies aiming to evaluate two characteristics normally associated with good governance practices: the percentage of independent board members and the existence of an audit committee in the board of directors.

Of the thirty companies analyzed, 12 simply did not have any information publicly available about their management, thus making it impossible to even find out who their directors and officers are. Among the 18 remaining companies, only about 16% of their board members were independent. It is a much lower figure, for instance, than the 30% reported for the 100 companies analyzed by Capital Aberto Magazine in 2009 in its Corporate Governance Yearbook³. Presuming that the 12 companies that do not offer publicly available information probably do not have any independents among their board members, the overall average percentage thus falls to a meager 9%.

This scenario is repeated when I analyze the audit committee. Of the 30 companies, only four (or 13%) publicly informed about the presence of an audit committee comprised of at least one board member (ALL, Sabesp, Fibria and CSN). This is a substantially lower figure than the 53% of public companies with audit committees that were identified in the aforementioned Corporate Governance Yearbook.

The overall result from the analysis of the largest credit operations from BNDES in 2009 is clear: the large companies that have received huge loans from the bank in general cannot be considered “role-models” in terms of corporate governance standards, thus weakening the argument that corporate governance is a key factor for the credit risk analysis by the bank.

Besides providing loans, the BNDES also acts as a large shareholder and bondholder of several companies through its subsidiary BNDESPAR. Its figures on this field are also impressive. At the end of 2009, the bank held securities issued by 198 companies (including shares of 155 firms) and was a large investor of 31 investment funds. The BNDES also had representatives in 24 boards of directors and was part of the shareholder agreement of 62 firms.

Regarding its role as a shareholder, 74% of BNDESPAR's investments in stocks (estimated in about R\$ 93 billion in market value at the end of 2009) were concentrated in 11 companies⁴, and the bank also held a significant amount of shares in 24 other companies⁵.

An investigation of the governance standards of these 35 companies where BNDESPAR holds a significant shareholding stake reinforces the idea that the bank does not pay enough attention to this issue. Only nine of these companies are listed on the Novo Mercado. In addition, we have applied a governance score analysis based on the governance scoring method developed for the annual award "The Best Brazilian Companies for Shareholders", prepared by Capital Aberto Magazine. The analysis revealed that the companies in which BNDESPAR invests have a governance score similar to the other listed companies analyzed. Once again, this indicated that the bank does not promote higher governance standards.

The group of companies where BNDESPAR is a relevant shareholder also includes some companies that were recently in trouble for bad governance practices, such as Fibria (a pulp and paper company that incurred in huge losses due to speculation with derivatives In 2008) and Copel (a state-owned energy utility that generated several complains from minority shareholders after decisions from its controlling shareholder that were harmful to the company's profitability). The group even includes companies that refused to abide to the new management compensation disclosure requirements set forth by CVM's Instruction 480 at the end of 2009. They include companies like Brasil Telecom, CPFL Energia, CSN, Klabin,

Gerda and Vale. Fibria's case is emblematic. BNDESPar is the largest single shareholder, with 33.6% of its voting shares. Still, the company chose not to disclose information regarding compensation, going against CVM's (the Brazilian Securities and Exchange Commission) new requirements on this field.

Finally, BNDESPar has approximately R\$ 6 billion invested in local bonds, with 87% of the money concentrated in nine companies⁶, only one⁷ being part of the Bovespa's corporate governance premium listing segment.

Given that corporate governance practices don't seem to be a key factor for investments by BNDES and its private equity arm BNDEPS, what could be done to improve this situation? Regarding loan operations, a simple yet effective manner of minimizing these issues would be to create specific criteria that would reward companies with higher governance standards. Some years ago, the bank itself went down this path by creating an incentive mechanism entitled "BNDES Program for the Adoption of Corporate Governance Practices". Through this program, companies that adopted certain predefined practices would be awarded with a bonus (reductions in the interest rates of its loans, an increase in the ratio of the bank's capital invested in the projects, or extended loan maturities). However, the program inexplicably was shelved before it was even launched. Another possibility would be to demand that companies undertaking operations worth more than a certain amount to go public, as a means of increasing their accountability and their monitoring by the market.

Regarding the bank's activities as a shareholder, it could follow the example of the International Finance Corporation (IFC), which ties its capital allocation in a large project to an objective commitment by the investee company to improve its governance practices. In the case of the IFC, a branch of the World Bank, companies are subjected to a corporate governance evaluation. Based on that, a "corporate governance progression matrix" is applied, consisting of five governance dimensions divided into four levels of evolution. At the end of

the process, approval for the operation is partially based on the commitment of the company to progress in each one of the governance dimensions under consideration. A similar tool could be developed by the BNDES.

These are simple measures that could clearly signal the bank's concern with the best governance standards, thus reducing the possibility of questioning about the criteria it used for its disbursements. In fact, the BNDES should look for the higher standards not only in a pursuit of alignment with the "best recommended practices", but to defend its own financial interests. After all, good governance tends to reduce investment risk (including reputational ones), as well as increase the probability of greater returns through better top managerial decisions.

This would be another of the various contributions of the bank to the development of the country, since environments with well governed firms tend to be more trustable to local and international investors, generating greater capital supply. "To spread the concept and incentive corporate governance" is already one of the formal goals of BNDES on its publicly documents⁸. The bank should now convince the market the he put this in practice.

¹ More information about BNDES can be found at

http://www.bndes.gov.br/SiteBNDES/bndes/bndes_en/Institucional/The_BNDES/

² The Economist, Nov12th 2009. A special report on business and finance in Brazil. Two Americas. Available at <http://www.economist.com/node/14829493>

³ <http://www.capitalaberto.com/english/index.php?pag=2&sec=10012>

⁴ Eletrobras, JBS, Vale, Valepar, Fibria, Copel, Brasileira, Telemar Participações, Petrobras, Banco do Brasil and Marfrig.

⁵ ALL Logística, Bom Gosto, Bradesco, Brasil Telecom Participações, Braskem, Brenco, BRF Foods, CEG, Cesp, Coteminas, CPFL Energia, CSN, Embraer, Gerdau, Itau Holding, Klabin, Light, LLX, MPX, Ouro Fino, Paranapanema, Rede Energia, Tele Norte Leste Participações, and Rio Polímeros.

⁶ Metalúrgica Gerdau, Vale, AG Telecom, LF Tel, Lupatech, ALL Logística, Suzano Papel Celulose, Gasmig and Votorantim Industrial.

⁷ Lupatech.

⁸ More information can be found at

http://www.bndes.gov.br/SiteBNDES/bndes/bndes_en/Institucional/Corporative_Governance/