



GESEL

Grupo de Estudos do Setor Elétrico

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Impacts of Corporate Governance on Companies in Brazil's Electricity Sector

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Textos de Discussão do Setor Elétrico

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Impacts of Corporate Governance on Companies in Brazil's Electricity Sector

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Abstract

Corporate Governance has arisen several critical manifestations on regulations and criteria of management practice. The analytical focus of this study is large companies from electricity sector which participate on stock exchanges. Since 2003, this sector has pass through a dynamic process of reconstruction which aimed to expand its capacity. It created possibilities of creation of strategic partnership among public and private agents and long term hiring. Therefore, state-owned companies became a vital instrument in order to seek investments. The new country dynamics brings companies from the electricity sector to seek for challenges. The objective of this study was to analyze the impacts of Corporate Governance on electricity companies. Although debates and pressure concerning adoption of right corporative and leadership practices have increased, companies of the electricity sector are marked by an increasing control of stock market, a low effectiveness of administrative counseling and by a high overlap between properties and management. At a moment in which the electricity sector is crucial concerning management of economic growth, it is essential to comprehend perspectives of change to which these companies are subjected to and their possible incomes.

Keywords: *growth of firms; corporate governance; electricity sector*

JEL code: *L1; L2; Q43*

1 - Introduction

The analytical focus of this study is the behaviour of companies in Brazil's electricity sector with regard to their decision-making process, especially the meaning and strategic significance of corporate governance. Since 2003, the sector has been undergoing a dynamic restructuring process directly connected to the steady consolidation of a new regulatory framework and to the economic stability over the recent years. The new regulatory framework is characterized by a set of rules that dropped down the perception of Brazilian electric system risk like:

- i.* the auctions for new transmission and generation plants (with 3 or 5 years ahead of estimated demand in the case of new power plants);
- ii.* the obligation for distribution companies to have 100% of their energy contracted;
- iii.* the need of a preliminary environmental licensee for a project to be allowed to sell energy through auctions;
- iv.* the long term (15 and 30 years) contracts that facilitate of external financing;
- v.* the concession granting process, formalized only after the energy is sold in the auction; and the adoption of a centralized planning system.
- vi.* the adoption of a centralized planning system.

From the side of the companies in the branch, the new dynamics of the electricity sector and its relationship with the economy prompt them to seek and meet new challenges, especially the need to adopt practices and methods based on the principles of corporate governance in order to compete for resources to finance growth.

The specific goal of this paper is to analyse the impacts of corporate governance on the Brazilian electricity companies. The initial hypothesis is that the chief companies in the sector have been extending the scope of corporate governance, which is contributing

to improved performance on the stock market and to attract fresh money for their development. The remainder of this paper is organised as follows: Section 2 presents some key concepts on the Theory of the Firm that are used on the paper. The analytical purpose of Section 3 is to trace a brief historical outline of corporate governance in the world and in Brazil. Section 4 examines the contribution of the São Paulo stock exchange (Bovespa) listings by level of corporate governance, and offers a comparison between share performance of the Bovespa overall and corporate government index listings. Section 5 examines the electricity sector firms in the Bovespa corporate governance share listings, and their participation in electric power generation and transmission. Final remarks are presented and discussed in section 6.

2 – The theory of the firm: a brief survey of key concepts.

Different conceptions of the firm can be identified in the history of economic thinking. According to Penrose (1959, p.10), the various schools of economic theory hold differing conceptions of the nature of the firm. This is because the firm is a complex agent and it is thus possible to choose certain particular features that suit the theoretical interest in discussing its nature, which is then defined on the basis of those chosen characteristics to the detriment of others.

Subsequent contributions to the Theory of the Firm (Cyert & March, 1956; Baumol, 1958; Penrose, 1959; Marris, 1967; Simon, 1969; Williamson, 1971, and others) shift the focus of attention from the market – which, via prices, plays a regulatory and fund allocation role – to frame the firm as a more autonomous decision-making and power unit. On these approaches, therefore, the profit maximisation principle gives way to analyses of company growth, determinants of investments, forms of financing, motivations and limits on expansion. Accordingly, the definition of the firm, when it attains such a size as to permit greater autonomy, must also consider its role as an

autonomous administrative planning unit whose activities can be interrelated with a number of production units coordinated by policies formulated with a view to their effects on the firm as a whole. In that case, there will be considerable variation in the number, scope and nature of the tasks attributed by the central administration to the various different units in favour of overall company growth, depending on the structure of the firm, managerial preferences and external pressures and changes.

The dynamics of capitalism obliges entrepreneurs constantly to seek new solutions in the various areas that make up company management, in order to enable it to improve its performance and competitiveness over competitors, i.e., to grow, increase its market share and its profits. In that regard, analysing company growth in economic terms means considering, on the one hand, the organisation's role in economic and social matters as it interrelates with other economic agents and, on the other, the complexity of mechanisms that affect firms internally.

According to Kon (1994), company growth entails constant adaptation in both internal and external environments, posing a series of problems of adjustment. One such problem involves adjusting to short-term conditions, i.e., to the decisions required to run the firm from day to day or month to month, which have to be resolved promptly, without internal routines holding back decision making. However, these have to be framed within the company's overall philosophy and strategic planning and, at the same time, a high degree of consistency has to be maintained between decisions originating from its various departments. For that purpose, the central administration can and should play a prominent and strategic coordinating role. Another kind of problem relates to adjusting to changes required by long-term policy, which arise as the company grows. Implementation of such adjustments generally stems from senior company officers.

In the modern firm, such adaptation to growth is effected by the various levels of the decision-making hierarchy participating jointly, so as not to overload the central

administration. Firms that achieve greater flexibility in this adjustment process enjoy greater possibilities of expanding their market and subsequently continuing to grow. Penrose (1959) sustains that a firm has at its core a continuous drive to growth: the firm is an accumulation of knowledge grounded in experience and in the aggregation of specific resources over time. There are thus no constraints on the absolute size of the firm as it is an agent that grows independently of any postulated size beyond which it cannot grow. Kerstenetzky (2000) sees this unique feature of the firm reinforced, on one hand, by uncertainty and, on the other, by the way firms solve their decision-making problems in a dynamic environment.

The final decade of the 20th century and first decade of the 21st are marked by significant growth in the size of corporations. These businesses' capital is divided up into shares and their shareholders' liability is limited to the issue price of the shares subscribed or purchased. The capital of limited liability corporations may be open or closed, depending on whether or not the securities they issue are admitted for trading on the stock market. Thus, firms whose capital is negotiated on the stock market are considered open corporations. The open corporation configuration is doubtlessly responsible for open corporations' growth over the past twenty years, due to having permitted major inflows of capital and intense trading of these companies' shares.

In order to increase companies' market value, and to confer stock market investors with greater transparency, some legal and conventional mechanisms have been set up over time, particularly to protect minority shareholders. These new management mechanisms are becoming increasingly complex. The concept of corporate governance is a prominent feature of this endeavour and is prompting a variety of critical manifestations with regard to normative proposals and criteria of good management practice.

3- Historical Aspects of Corporate Governance

3.1. Corporate governance in the world

The development of corporate governance rules emerged as a solution to regulators', shareholders' and investors' pressure for better standards in companies' management. Regulators must act to correct distortions and preserve the well functioning of capital markets as it happened with the approval of Sarbanes-Oxley Act, for instance. Shareholders and investors pushed companies and regulators for rules and practices for better transparency and equal treatment among shareholders.

The first movements towards corporate governance emerged in the United States and were adapted in other countries to suit their particular conditions.

In the 1950s and 60s, there was a strong wave of mergers and buyouts among North American firms. As their capital was highly pulverised, this led to a problem of a lack of power in the hands of minority shareholders. The history of corporate governance in the Americas is thus connected with disputes for control of power in corporations, particularly by minority shareholders.

In the 80s, corporate governance changed direction: intense criticism of the lack of transparency in company administration strengthened the advocates of more effective action by shareholders in generating surplus value and wealth.

In the 90s, minority shareholders were seen to have gained greater power in company administration and, as a result, investments by pension funds had increased significantly. More precisely in 1992, the term Corporate Governance was used in England in the Cadbury Commission Code of Best Practice, known as the Cadbury Report. In 1994 General Motors issued its Corporate Governance Guidelines in the United States. In 1999, the OECD published a technical report titled Principles of Corporate Governance, with a view to assisting member countries in institutional evaluation and improvement towards good corporate governance.⁵

5 The historical analysis presented here is based on: SILVA, Edson Cordeiro da. **Governança Corporativa**

In the present decade, major developments can be seen in corporate governance worldwide, especially since the failure of the Enron group in the United States. In 2002, the USA passed the Sarbanes-Oxley Act setting out a series of rules of corporate governance practice and penalties for non-compliance. This new law is designed to ensure that boards of directors are effective in defending the interests of all shareholders. Although it creates obligations only in the USA, it can be said to put forward a normative framework for corporate governance worldwide. In 2005, the OECD published the OECD Guidelines on Corporate Governance of State-Owned Enterprises and came to bring its influence to bear on the issue.

The financial crisis that swept world markets in 2008 impacted management practices decisively in manners before unimagined. Monitoring processes of corporate management suffered a consolidated change. Internal oversight bodies, such as boards and audit committees, as well as independent audit firms and risk assessment agencies undergone major operational overhaul, renewing their concepts and adopting more stringent procedures in their work routines.

The reasons for such changes are evident. It is clear today that the whole debacle resulted from derivatives operations leveraged by *sub-prime* loans. These flourished in the wake of the *lenience*, or even *negligence* of the administrative bodies, audit committees and risk assessment agencies that were clients and suppliers to major financial corporations.

The National Association of Corporate Directors (NACD), the organisation responsible for evaluating corporate governance in the United States, has embarked on a series of discussions of the role of company boards and their responsibility in the context of the 2008 crisis. One of the recommendations⁶ was to involve shareholders in the executive-dominated selection of the directors, thus increasing the independence of the latter. Executive remuneration is seen as one of the key

triggers of the crisis and a change of paradigm is supported: compensating directors according to selected qualitative and quantitative indicators, as opposed to the stock price. As a consequence of the latter method, inappropriately large bonus payments were attributed to executives for attaining míope, short-run objectives. Furthermore, regulation played its part, as there existed mandatory transparency requirements, which for unknown reasons had not been properly enforced by the Securities and Exchange Commission (SEC). The need to renew concepts and to upgrade the operating routines of oversight authorities appears as an outcome of the on going world crisis, yet this is not the focus of the present paper.

3.2. Corporate governance in Brazil

In the 50s and 60s, most Brazilian private firms were controlled by majority-shareholding families often hindering boards from acting in an efficient and independent way. Meanwhile, in 1976, there were the approval of a new Brazilian Corporate Law (*Lei das Sociedades por Ações no Brasil, Lei 6.404*) which replaced an old and outdated code enacted in 1940 and the creation of a Securities and Exchange Commission (*Comissão de Valores Mobiliários, CVM*).

By the mid-1990s, corporate governance had made little headway in Brazil. The National Institute of Boards of Directors, (*Instituto Brasileiro de Conselheiros de Administração, IBCA*) later the Brazilian Institute of Corporate Governance was set up in 1995 (*Instituto Brasileiro de Governança Corporativa, IBGC*). In 1997, a review of legal framework (Law 9.457) preserved the responsibilities of the boards and increased the CVM's oversight powers. In 1999, the IBGC issued the Code of Best Practices in Corporate Governance, where the main models and practices were subjected to intense scrutiny. A period of conspicuous evolution ensued in the institutional and corporate environment in Brazil. In 2001, the São Paulo Stock Exchange (Bovespa) brought in listings by levels of governance (*Níveis Diferenciados*

de Governança) and the “new market” (*Novo Mercado*), tied to corporate governance commitments (refer to the next Section for additional discussion about Bovespa’s Special Segments for Stock Listings).

In the end of 2007 there was the approval of a new accounting set of rules (Law 11.638) with the adoption of the International Financial Reporting Standards – IFRS which is going to be fully applied on financial reports preparation starting in 2010 onwards.

As a consequence of the 2008 financial crisis, two movements emerged in Brazilian firms. The first is related to risk management: probabilistic models which have proven to be ineffective in stress situations, were deemed unable to protect investors from external risks. The second movement is towards reviewing the practices of corporate governance.

Traditional Brazilian firms with good standing on the stock market denoted sudden, substantial losses in operations with exchange derivatives, illustrating the need for a thorough review of management procedures and governance practices. What was striking about certain operations was not the use of hedges to protect exporting or importing companies against exchange fluctuations, but the asymmetry between possible losses and gains and the absence of any opinion emitted by the collegiate bodies responsible for administering and overseeing such decisions. A considerable part of these manoeuvres proved to not be protective operations, but merely reckless speculation.

Still fresh in the collective memory, the crisis is seen as an outstanding opportunity to rethink the governance structures, having kindled deep developments in rules and relationships. At the same time new forms of risk control are developed, these two aspects being intimately related.

By the end of 2009 CVM improved the regulation related to public offerings and to listed companies (Instruction CVM 480) and introduced the obligation for this type

of companies to fill a special form (formulário de referência) and to keep it constantly updated with a series of information regarding to Company's history, financial data, risk factors, relevant assets, management analyses, corporate governance and others. The introduced form is similar to the one existing in the American market (Form 20F).

4. The Contribution of Bovespa's Special Segments for Stock Listings

In the late 1990s, the Bovespa started to design a new environment to trade stocks where investors could find companies with corporate governance standards similar to the ones existing in the most developed centres. Considering that the basic Brazilian corporate law did not provide a set of rules compatible with such standards, the Bovespa developed three special segments with different levels of corporate governance requirements: The Novo Mercado, Level 2 and Level 1. Each of them has specific regulation that can be adopted voluntarily by companies interested in listing their shares and in providing higher rights than the basic law does. Once a company adheres to a specific level it commits to follow the rules of that level, apart from the provisions of the basic Brazilian corporate law (when a provision in the Special Segment regulation is more demanding than in the basic law, the Special Segment rule prevails).

Until the creation of Novo Mercado and the other segments, the traditional and historic stock market in Brazil was mainly comprised by companies with very poor corporate governance practices. Based on the Corporate Law, many groups and families could control listed companies with a mere participation of only 16.5% of total shares while maintaining unlimited management rights. Shares traded in the stock market were basically securities without voting rights (preferred shares). For a long time, a company could issue up to two thirds of

this type of shares⁷ which means that half of the remaining third plus one share would give full controlling power.

Table 1
Main Features of Bovespa's Special Segments for Stock Listings

	Novo Mercado	Level 2	Level 1	Basic Law
Minimum free float	25%	25%	25%	No provision
Type of shares	Only ON ⁸	ON and PN with some special features	ON and PN	ON and PN
Board of Directors	At least 5, with 20% of independent members ⁹	At least 5, with 20% of independent members	At least 3 members	At least 3 members
Finance Reports under intl standards ¹⁰	US Gaap or IFRS ¹¹	US Gaap or IFRS	Optional	Optional
Tag along rights	100%	100% of ON 80% for PN	80% for ON	80% for ON
Adoption of Arbitrage Clause	Obligated	Obligated	Optional	Optional
Additional Financial Disclosure ¹²	Yes	Yes	Yes	Do not apply

In order to examine the impact of corporate governance on companies and provide input to capital market investors, the Bovespa set up an index called the differentiated corporate governance index (*Índice de Governança Corporativa Diferenciada, IGC*). This index is a portfolio comprising stocks of companies listed in special segments of the Bovespa. The

⁷ This limit was reduced to up to 50% by Law 10.303 in October 2001.

⁸ ON: common shares. Shares WITH voting rights
PN: preferred shares. Shares WITHOUT voting rights

⁹ According to the New Market regulation, an independent board member is basically a member with no connections with the company (except as a non controlling shareholder), with its managers and with the controlling shareholder(s).

¹⁰ Some companies not listed in Novo Mercado or in Level 2, have their shares also traded in the NYSE and are obliged to prepare financial reports according to Brazilian and to US GAAPs (Generally Accepted Accounting Principles) and comply with the US regulation applied to foreign issuers.

¹¹ International Financial Reporting Standards

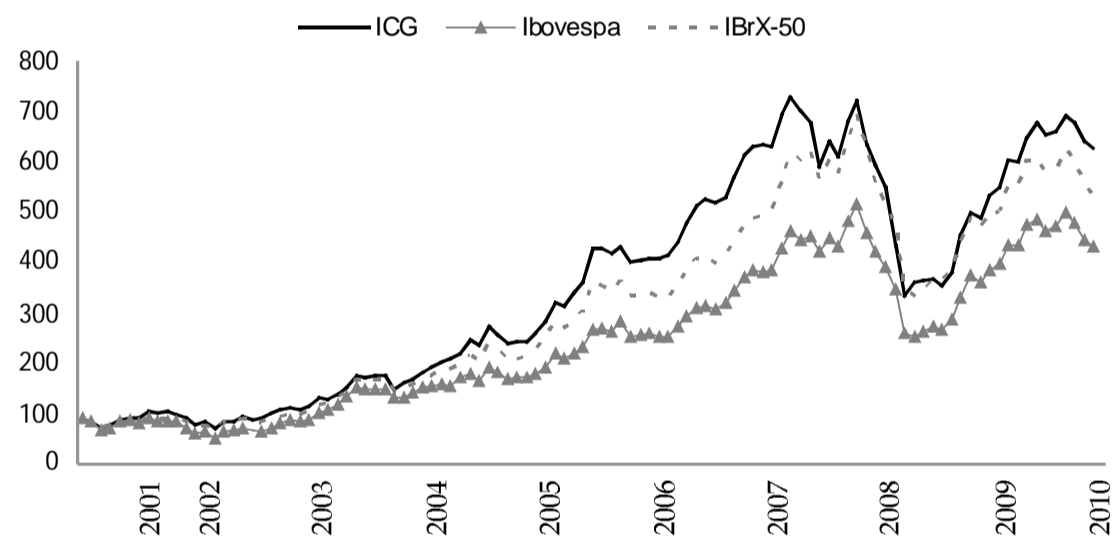
¹² The regulation of the Special Segments determines a series of financial information that companies are obliged to disclose to investors and are not required by the basic law.

special segments list the shares of companies with graduated different levels of corporate governance practices. In May 2010, the Level 1 special segment comprised 34 companies, whilst Level 2 had 19 and the New Market (*Novo Mercado*) 105, representing around 42% of the 375 companies listed on the Bovespa.

Since the IGC was put in place in June 2001, its share prices have performed significantly better than the overall Bovespa indexes (Ibovespa and IBRX 50). Notwithstanding, when the international financial crisis worsened in mid-2008, share prices fell across all market segments on the Bovespa, as shown in Figure 1:

Figure 1

Evolution of the main Brazilian stock market indicators (Base 100): July 2001 to June 2010



Source: Bovespa, 2010.

Thus, there are strong signs that, in times of financial stabilisation, firms in Bovespa's listings by differentiated levels of corporate governance enjoy a sustained tendency for their shares to appreciate and to capitalise more than companies not included in the listings. That trend occurs mainly due to the elevated level of

transparency required for these companies. They have signed undertakings to provide information to facilitate monitoring and oversight of their boards' and company controllers' actions and, specially in Novo Mercado and Level 2, to adopt corporate rules that foster greater harmony among the rights of *all* shareholders, regardless of their status as controllers or investors. Such undertakings ensure an environment favourable to minority investors, by generating greater overall investor confidence and consequently greater growth potential for the value of the company.

According to Scaletsky (2007), corporate governance gives management greater autonomy, at the same time creating mechanisms to reduce the risk of misappropriation of added value by managers and the corporation. From that perspective, Carvalho (2003) has demonstrated empirically that migration to the Bovespa's differentiated levels of corporate governance listing has had major impact on companies' share values in terms of abnormal positive returns. That characteristic, he claims, has brought about an increase in the volume traded, augmenting the liquidity of titles and possibly reduced the impact of macroeconomic volatility on their prices.

The Bovespa initiative with the Special Segments proved to be an enormous success as companies became to raise money by listing their shares only in Brazil. Before the Special Segments (and specially its *Novo Mercado* level) it would have been practically impossible to gain access to equity investors without going through The New York Stock Exchange - NYSE. According to the Bovespa presentation to investors (March 2010) since 2001 to March 2010, there were 122 IPO's (initial public offerings) and 103 *follow on*¹³ transactions. Of these 225 public offerings, only 5 companies decided to double list their shares (Bovespa and NYSE). Together with the Brazilian economic stability which has been fundamental to attract foreign investors to local markets, the Special Segments helped the Brazilian stock market to recover and get international recognition and the Bovespa to be by far the major stock exchange in the region. Table 2 bellow shows the amount of money raised through public offerings over the last years:

13 A follow on transaction is a public offering made when the company has already their shares traded in

Table 2

Bovespa – Public Offerings
(in BRL billion)

*until 04/08/2010

year	IPO	Follow ON	Total
2004	4.5	4.3	8.8
2005	5.4	8.5	13.9
2006	15.4	15.1	30.5
2007	55.6	14.5	70.1
2008	7.5	26.8	34.3
2009	23.8	22.2	46.0
2010*	6.3	4.0	10.3
total	118.5	95.4	213.9

Source: Bovespa presentation to investors (March/10)

5 – Corporate governance in Brazil's Electricity Sector

In most developing countries – and Brazil is no exception – the infrastructure sector, and especially the electricity sector, is one of the key concerns for economic growth strategies, with implications for both cost reduction and the efficiency of the economic system as a whole. Expanding investment in domestic industry is a fundamental precondition for achieving and sustaining growth rates compatible with social development needs.

Investments in the electricity sector have specific features, namely:

- i.* long maturity timeframes;
- ii.* large fund volumes;
- iii.* strong impacts on the production chain;
- iv.* predictable cash flows;

In this regard, the electricity sector needs to fund its investments constantly. One source of

the stock exchange.

financing for electric power enterprises is the stock market. Investments in shares are strategically important to materialising projects and maintaining an appropriate capital structure.

As a result of the privatization process in the late of 1990, several new groups arose in Brazilian electricity sector. For some of them, one way to capitalize and reinforce their capital structure was through the stock market. As shown in Table 3, Brazilian electricity companies or their shareholders raised more than BRL 13 billion via shares' public offerings since 2004.

Table 3
Brazilian Electricity Companies Public Offerings

Company	Segment	Offer Type	Year	Volume BRL million
CPF Energia	Novo Mercado	IPO	2004	821
AES Tietê	Tradicional	Follow on	2005	1,059
Energias Brasil	Novo Mercado	IPO	2005	1,185
Tractebel	Novo Mercado	Follow on	2005	1,052
Equatorial	Level 2	IPO	2006	540
Cesp	Level 1	Follow on	2006	3,200
Eletropaulo	Level 2	Follow on	2006	1,345
Terna Partic.	Level 2	IPO	2006	627
MXP Energia	Novo Mercado	IPO	2007	2,035
Light S.A.	Novo Mercado	Follow on	2009	772
Energias Brasil	Novo Mercado	Follow on	2009	442
total				13,079

Source: Bovespa

Brazil's electricity sector comprises numerous firms the shares of which are traded on the stock market. For the purpose of measuring these firms' performance, the Bovespa has a specific electric power index (*Índice de Energia Elétrica*, IEE). However,

the composition of the national IEE does not include all the electricity sector companies, but only those meeting the following requirements:

- i.* they have participation in terms of financial volume traded equal to or higher than 0.01% of the Bovespa spot market over the last twelve months;
- ii.* they have been traded in at least 80% of the total trading sessions of the period;
- iii.* they have had at least 2 trades per day in 80% of the trading sessions in which the stock was traded.

The composition of this portfolio from January to April 2010 is shown in the chart below:

Table 4
Composition of the Bovespa IEE. May to August, 2010

StockT	ype	(%)
AES TIETE	PN	5.859
CELESC	PNB	5.887
CEMIG	PN	5.783
CESP	PNB	5.870
COELCE	PNA	5.918
COPEL	PNB	6.002
CPFL ENERGIA	ON	5.748
ELETROBRAS	PNB	5.880
ELETROPAULO	PNB	5.789
ENERGIAS BR	ON	5.923
EQUATORIAL	ON	5.919
IENERGIA	ON	5.849
LIGHT S/A	ON	5.881
MPX ENERGIA	ON	5.899
TERNA PART	UNIT	5.921
TRACTEBEL	ON	5.901
TRANS PAULIST	PN	5.973
total		100.00

Source: Bovespa, 2010

Meanwhile, some Brazilian electricity sector firms that have shares traded on the Bovespa are also in the Bovespa differentiated levels of corporate governance listings. These firms have endeavoured to adapt to Special Segments requirements so as to offer investors greater management quality and transparency and to attract more investment. The companies that make up the IEE and also figure in the Special Segments for stock listings are shown in Table 5:

Table 5
Electricity companies in the Bovespa's Special Segments for Stock Listings

Novo Mercado	Level 1	Level 2
CPFL ENERGIA S.A.	ELETROBRÁS	CELESC
EDP ENERGIAS DO BRASIL S.A.	CESP	ELETROPAULO
EQUATORIAL ENERGIA S.A.	CEMIG	TERNA PART
LIGHT S.A.	COPEL	
MXP ENERGIA	TRAN PAULISTA	
TRACTEBEL ENERGIA S.A.		

Source: Bovespa, 2010. Compiled by the authors.

Comparing tables 4 and 5, it can be seen that from the seventeen companies in the IEE, only three – AES Tietê, Coelce and Ienergia – are not listed in the Special Segments. Thus, the companies that have pursued a differentiated level of corporate governance control a large part of Brazil's generating capacity and transmission lines (Table 6):

Table 6

**Share of the generating and transmission matrix by Brazilian electricity sector
companies listed in the Bovespa Special Segments. 2010**
(% of the respective total)

Company	Generation	Transmission (230-750 KV)
CELESC	0,07	
CEMIG	6,48	5,2
CESP	6,92	
COPEL	4,55	1,9
CPFL Energia	0,15	
ELETRORÁS	38,00	56
ENERGIAS BR	0,01	
EQUATORIAL	-	
LIGHT S/A	0,91	
MXP ENERGIA	0,34	
TERNA PART	-	
TRACTEBEL	6,46	
CTEEP	-	9
total	63,89	72,1

Source: Aneel, Abrate and Eletrobras. 2010.

There are other companies with stocks traded in Bovespa's Special Segments, having assets that add up to the Brazilian generation capacity but that are not included in the IEE. This is explained by having their main activities related to different sectors. Prominent among such companies are Petrobrás (Bovespa Level 1 – 8.53% of total generation in Brazil) and Vale (Bovespa Level 1 – 1.76% of total generation in Brazil). Thus, Table 8 understates the generation market share that belongs to companies in the IGC index.

The contribution of this type of companies to the Brazilian electric system is likely to improve in the near future as there exists an obligation for the special purpose entities (SPE) that won the auctions for the Rio Madeira (Santo Antônio and Jirau) and

for Belo Monte hydroelectric power plants to comply with key corporate governance rules of the Bovespa Novo Mercado¹⁴. This trend is occurring in response to market demands and requirements by the most important lender for infrastructure projects in Brazil – BNDES, the Brazilian Development Bank, which has been acting together with some leading institutional investors like large pension funds, as a special “promoter” of corporate governance improvement across Brazilian enterprises. It means that not only public companies have embraced better management standards but also the others not listed to facilitate access to credit markets and to enjoy lower costs.

So there can be no denying that, by and large, Brazil's electricity sector is administered by companies with purposes of good levels of corporate governance and that the tendency is for increasing participation by companies and consortia with these characteristics. Even some state-controlled companies in Brazil's electricity sector have started efforts to improve corporate governance practices. One example is the Eletrobras System which plays a strategic role in administering Brazil's energy capacity and it is one of the major investors in the sector. At the end of October 2008 its shares started to be traded on the New York Stock Exchange (NYSE) when its American Depositary Receipts (ADR) upgraded to level II. In addition, the holding underwent a restructuring process that included setting liabilities in order, coordinating closely subsidiaries activities and adopting a less decentralized decision making process.

However, it is necessary to mention, as the three different levels in the Special Segments demonstrate, that there are commitments to diverse levels of corporate governance principles and, more importantly, corporate governance is more about a consistent daily practice than a formal adherence to a regulation. Because of these two points, there are substantial differences among companies in the sector with difficulties arising from their structure of control and in different stages in the way towards high levels of corporate governance.

The capital market is highly important for the electricity sector due to the high and swelling volume of investments necessary to expand installed capacity in the industries' three segments (generation, transmission and distribution). Thus, it is fundamental that electricity companies' shares be attractive to investors in order to raise the necessary volume of funding at a suitable cost of capital. The corporate governance practices adopted by electricity sector companies are designed to bolster investor confidence and obtain better share performance.

Conclusion

Over recent years, Brazil's economy can be seen as making a strong progress in consolidating macroeconomic fundamentals and stabilising its institutional environment. These results enable the economic authorities to move ahead in implementing a programme that in practice means that macroeconomic policy is being aligned with an endeavour by Brazil to achieve sounder, more sustainable growth.

The Brazilian stock market is enjoying greater international visibility, revealing a solid environment to the eyes of foreign investors who also seek long-term prospects, contributing thus to the sustainability of financing infrastructure and industry.

The clearly defined rules of the electricity sector regulatory framework tend to make the sector steadily more attractive to capital investment. According to the recent evolution of investment in the sector, it is expected to continue to receive external funding as a result of rising levels of confidence, associated with a well-defined model of rules for auctions and concessions.

Many publicly traded companies in the Brazilian electricity sector have been updating their practices in order to give a proper answer to investors and shareholder demands regarding corporate governance. The existence of de Bovespa's Special Segments for stock listings helped this movement to happen and have made possible for several companies to raise money through IPO's or *follow on* operations and to enjoy an adequate valuation of their shares. The direction has not been avoided by state controlled companies, either – as the achievements of Eletrobás remind.

In any company, the financial arrangements directed to maintaining and/or expanding its production activity depends on the interaction among its operating funds (resulting from the company's operations, i.e. its revenues), third-party funds and shareholders' equity capital. These resources form the company's economic and financial structure and are one of the pre-requisites of corporate governance. Accordingly, it can be seen to be increasingly attractive to invest in electricity sector

companies that adopt corporate governance practices. To summarize, these strengthen *all* investors' confidence, prompt greater demand for publicly traded shares, reduce volatility. Furthermore, these companies' shares performance on the stock market yield a series of benefits, which include lower cost of capital and greater volume of investments, boosting growth and profitability in turn.

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