A Review of Disclosure Practices of Latin American Companies

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Abstract

This paper analyzes current practices in several Latin American countries in the areas of corporate disclosure and transparency by focusing on the extent to which information is disclosed to investors through public channels, such as websites. We find weak disclosure practices, which will continue to prove problematic for capital flows and the future development of these countries. Poor disclosure practices lead to reluctance on the part of investors to invest in these companies, high costs of capital and poor valuations. Latin American firms should be encouraged to voluntarily increase disclosure, select independent boards, and enforce disciplinary mechanisms that improve investor protection.

Keywords: Latin America, corporate governance, capital flows, disclosure.

Introduction

With increased focus on sustainable finance practices, the governance practices that companies employ are also under greater scrutiny. Disclosure is the foundation of good corporate governance practices, benefitting companies, investors and markets. As a result, reporting is perceived to be the most effective tool that regulators have to encourage better corporate governance. Disclosure allows investors access to material information they need to make informed value-adding decisions, which promote economic growth through increased efficiencies, innovation and lower costs of capital.

The recent economic challenges have elevated the importance of disclosure practices for sound economic decision-making. Such practices become even more important for emerging economies, as these countries aim to mobilize capital and achieve economic growth. Among emerging economies, the Latin American region is of significant concern. These economies struggle with below potential economic growth and inability to attract and keep investments, ultimately leading to increased poverty levels and loss of output which further damage investments and growth. In this context, disclosure and transparency are critical tools that governments and corporations must focus on to help investors feel confident about making business in the region.

This paper provides data and a review current corporate disclosure practices in Latin American countries by focusing on the extent to which information is disclosed to investors through public channels. We begin by reviewing the prior research in this field, and then proceed to presenting the data identified and to interpreting our findings.

Prior Research

Until recently, many believed that Latin America was a story of economic success. Year 2004 marked the start of the so-called Latin American decade, one where the region experienced exceptional economic growth and social progress. Capital flows had returned to Latin America in the 1990s following the debt crisis and return to democracy of the 1980s, the region also experienced long-term improvements in human development as a result of increased social spending which facilitated the expansion of education, health and other social services. In fact, as advanced economies were severely affected by the crisis of 2008-2009, the emerging market economies of Latin America were seen as part of the promise for renewed economic growth.

Following the economic boom of 2004-2013, the current outlook for the region is grim. Among other factors, capital flows invested in Latin American countries have not always helped improve these countries financial stability. Capital flows in Latin America have been known to both hurt and improve the economies of these countries, and often lead to recessions throughout Latin American economies.

Capital flows to these countries are often in the form of short-term investments, and, usually, once capital flows reach record levels, they quickly drop off and start to decrease. For example, following a record of $88 billion in net private flows to Latin America in 1997, capital flows to these economies quickly declined after. Capital flows to Latin America reached another record in 2013, and are now gradually decreasing again. One interesting pattern noted about capital flows to the region is that they increase U.S. interest rates decrease or recessions begin in industrialized countries. With the U.S. steadily climbing out of the recession and interest rates expected to rise, slowing expected to rise, investors are finding it appealing to move capital out of the Latin American economies.

Global crises and conflicts can lead to capital flows to quickly stop in Latin America, which leads to Latin American countries struggling financially. In this context, it is imperative for governments and businesses to implement policies that attract capital to region, and there has been a push for foreign countries to bring long-term flows of money in these countries, and these countries now seek to attract foreign direct investments (FDI) because it is more stable, and stimulates growth and access to foreign markets.

Some studies note that, while capital flows are generally thought of as a positive and necessary for growth in emerging countries, they also raise concerns. For example, Moreno (2012) notes that capital flows to Latin America are sometimes used to finance “unsustainable spending” while countries or regions are expanding. Another concern is that they could lead to excessive risk-taking and credit growth, and financial decisions that lead to maturity mismatches. The reversal patterns noted for these economies amplify such concerns. To reduce the damage from reversed flows, Latin American countries have managed to maintain account surpluses and reduced maturity mismatches, so that when financing is reversed they are able to bankruptcies and unemployment.

Overall, research seems to indicate that the benefits of capital flows outweigh the challenges posed by increased capital flows. For example, prior research shows that the entry of foreign MNCs in the region has increased productivity despite relatively the low levels of innovation undertaken by multinational affiliates operating in the region (Lederman et al., 2013)). These productivity gains are the result of knowledge and technological transfers from multinational affiliates to local firms, especially through local suppliers. Additional empirical work on Mexico (Blomstrom, 1983), Uruguay (Kokko et al., 2001) and Venezuela (Aitken and Harrison, 1999) also show higher labor productivity in foreign-owned firms than in local firms. Furthermore, Bloom et al. (2012) show that foreign-owned firms in Argentina, Brazil, Chile and Mexico have better management practices than local firms, thus supporting the idea that multinational affiliates import knowledge from headquarters.

Latin American countries have started to reform monetary policies and eliminate budget deficits to encourage long-term capital flows and establish “creditworthiness”. Given the volatility and uncertainty of capital flows, Latin American countries are increasingly recognizing the need to develop policies that ensure that their economies continue to grow without a constant short boom and bust cycle. Unlike short-term investments, long-term investments such as those made through FDI would significantly decrease the unpredictability that is associated with majority of Latin American economies. Reducing credit growth, and minimizing mismatched maturities will also improve the outlook for financially stability.

While the government push for reform is evident, some researchers (Claessens and Yurtoglu, 2012) also note that countries do not always reform their corporate governance frameworks to achieve the best possible outcomes as such initiatives require a mixture of legal, regulatory, and market measures, making for difficult and slow progress.

Prior researchers note that corporate governances in South America are similar to U.S. corporate governance in the way that rights of minority shareholders, public stock offer, and public meetings are listed. However, due to the difference in economies and type of shareholders, there are differences in the corporate governances (Reyes, 2006). It was also noted that corporate governance practices vary across Latin American organizations, with state-owned enterprises typically following OECD guidelines, and governance for publicly-traded companies varying on the type of shareholders they have. According to the OECD guidelines, corporate governance refers to an effective legal and regulatory framework, ownership function and oversight mechanisms, transparency and disclosure of information, and the role of the boards of directors. According to these guidelines, companies should be transparent and accountable, and establish clear ownerships policies.

Regardless of the type of company, engaging in the best disclosure and transparency practices would be appealing to investors. There has, in fact, been a push here has been a push for more precise transparent corporate governance practices as research shows that investors are willing to pay more for a “well-governed” company, and a corporation can prove how well they manage their company in a corporate governance (Reyes, 2006)).

Thus, in addition to work by governments to implement policy changes that attract foreign capital, prior studies suggest that improved corporate governance practices would help attract capital to the region. In fact, a recent survey by Khanna and Zyla (2012) shows that that emerging market investors find transparency and disclosure to be of critical importance, with all of the investors surveyed saying that willingness to disclose factors heavily into their decision making. Their survey respondents also noted that opacity of disclosure could cause concerns about compliance with the U.S. Foreign Corrupt Practices Act, and could be an indicator of additional problems in the company leading investors to potentially decide against making an investment in the firm. This is consistent with previous research suggesting that increased disclosure appears to make firms more attractive investments (Hermalin and Weiback, 2009) and to also attract foreign investors (Leuz et al., 2009).

This is highly relevant given that misconduct alleged to have occurred in Latin America has been the focus of a growing number of corporate dispositions and investigations under the Foreign Corrupt Practices Act (FCPA). From 2005 to the present, twenty-two concluded FCPA corporate enforcement actions have included a Latin America component. This represents approximately 20 percent of the total number of corporate FCPA enforcement actions during this period. In addition, allegations of misconduct in the region have been at the core of a number of criminal prosecutions and civil enforcement actions against individuals in recent years, including actions against fifty-five individuals initiated since 2005. (Yannett, 2013).

Good corporate governance in the region is critical given the ownership structures characteristic to Latin American countries. The massive privatization that followed the 1980s debt crisis led to an increased ownership concentration and centralized controls from *grupo económico*, or just grupo, became predominant in most businesses and corporations. Most grupo factions are family owned or owned by a controlling interest with the ability of blockholding. The largest companies based in Latin America are extremely diversified with different factions of their company using technology or resources that are different for each faction. The need to diversify is mainly caused by the volatility of the macroeconomic environment in Latin America. Smaller markets and economic unease in the past have made businesses in Latin America look into options that offer stability.

Most Latin American companies remain tightly controlled by founding families or shareholder groups, though increased pressure from investors over the recent years has led many companies disperse their ownership structures. The influence of grupos in the local markets has made it difficult for multinational companies to overtake the Latin American ‘local’ business because of the preferential access to capital, policymaking, and information that grupos have. Some researchers even argue that grupos are beneficial because they allow managers to work without the fear of public perception, minority stakeholders, or analysts. Prior studies have suggested that concentrated ownership maximizes shareholder value because a large ownership stake provides managers with incentives to increase cash flow and valuations (Morck, Shleifer and Vishny, 1988; McConnell and Servaes, 1990).

However, studies have also shown that investors choose to become controlling investors in countries in weak investor protection in order to maximize their “private” benefits of control. In fact, prior work by shows that highly concentrated shareholdings arise as investors respond to weak contracting environments by building up controlling stakes sufficiently large to provide proper incentives to monitor management (La Porta et al., 1998) In other words, investors in weak legal environments may become controlling shareholders not only to protect themselves from expropriation, but also because they are better able to expropriate from the firm themselves (Giannetti and Koskinen, 2004). Thus, the rise of the Latin American grupos is expected given the high corruption practices in the region and low monitoring and enforcement practices.In fact, multinational firms typically direct foreign direct investment more often to countries with weaker investor protection (Kelley and Woidtke, 2006).

Unfortunately, in the context of corporate governance, large owner holdings are problematic and lead to agency conflicts between majority and minority shareholders (Berglof and Pajuste (2003)) causing the protection of minority shareholders to become increasingly important issue in the region. Furthermore, corporate governance is related to performance and valuation as shown by prior studies. For example, Klapper and Love (2004) find that firms that are faster growing, those that are less capital intensive, and those that issue ADRs are more likely to adopt stricter corporate governance provisions. In addition, firms with greater sales growth and a lower percentage of fixed assets, may find it easier to expropriate from minority shareholders and therefore may find it optimal to impose ex-ante stricter governance mechanisms to prevent ex-post expropriation (Himmelberg et al., 1999).

It could be argued that stricter corporate governance mechanisms may be costly for controlling shareholders. Prior studies have also suggested that firms may find it beneficial to increase investor protection and adopt better corporate governance mechanisms in order to improve firms' access to external finance and to increase investors' willingness to provide financing and therefore improve firms' access to external finance (LaPorta et al., 1998). For the US, it has been shown that firms with stronger shareholder rights have better operating performance, higher market valuation, and are more likely to make acquisitions (Gompers et al., 2003).

In fact, research suggests that corporate governance practices play an important role in economies characterized by weak institutional environments. For example, despite a weak operating environment, Russian firms can increase their value substantially by improving their corporate governance unilaterally (Black, 2001). Similar evidence exists for Korean firms, although, in this case, private mechanisms often are not sufficient but need the support of government intervention (Black et al., 2003). Similar evidence is documented for Central and Eastern European firms, where prior studies that improved corporate governance practices for individual firms cannot fully compensate for the weak institutional environment existent in Central and Eastern Europe (Durnev and Kim, 2005; Klapper and Love, 2004).

Given the challenges that Latin American economies currently face, proper disclosure and transparency would make it easier for investors to overcome the high costs of collecting information and enforcing contracts that are typical for emerging economies. This would help reduce the likelihood that managers will engage in behaviors that misappropriate shareholder wealth by monitoring and punishing management, and would provide investors with information needed to make confident decisions.

In what follows, we concentrate on the information disclosed by Latin American companies. Specifically, we focus on the extent to which Latin American companies emphasize disclosure and transparency in their communication with investors and stakeholders. Prior research shows that greater disclosure of corporate governance lowers information asymmetry and estimation risk and should improve financial performance, reduce risk and raise investor confidence (Diamond and Verrecchia, 1991). Hence, firms could create information symmetry by ensuring outside investors have easy access to firm performance and governance policies.

Current Evidence

While specific corporate governance rules often are controversial, most observers agree on the importance of disclosure and transparency within the corporate governance structure. Some could argue that disclosure may be costly and so effort and money spent on disclosure should be reduced to save costs during times of financial difficulties and limited resource availability. Yet, Isenmann & Lenz (2000) show that the use of new information technologies has had an enormous impact on the standards of availability and diffusion of information, introducing determinant advantages as readiness, low effort, and low cost in communication. Following the increased use of the Internet in the recent years, companies should find it relatively easy and cost-efficient to quality information to their investors. Increased disclosures would help minimize information asymmetries between controlling shareholders and managers, on one side, and foreign investors and minority owners, on the other side.

Transparency and disclosure are important for the well-functioning financial markets. Disclosure allows investors access to information the ensures the proper accountability of organizations to their boards, investors, shareholders, regulators and other stakeholders. Transparency allows communities to fight fraud and corruption and helps protect investors from information asymmetry.

In this paper, we started by analyzing twenty Latin American countries and identifying company information by pulling company data from the local stock exchanges. The unavailability of company information restricted our search to 1097 companies located in five Latin American countries, namely the Brazil, Mexico, Argentina, Chile, and Columbia. We then proceeded to analyze what information is disclosed to investors. Given survey data that suggesting that emerging market investors find transparency and disclosure to be of critical importance, we examine firm-level data to see what firms are actually disclosing, and what determines how much they disclose.

By communicating with the market and making information available, a company conveys a lesser or greater degree of transparency to its activities, which will consequentially contribute to the formation and accumulation of reputation for the corporation, thus possibly helping significantly to maximize its future performance (Djankov et al., 2001). The focus of this work is on information that companies choose to make readily available in English to their investors, given that English is the language of widest international circulation. Given there are roughly 500 million Spanish speakers worldwide and the language spoken in all the countries analyzed except Brazil, companies that wish to make information easily accessible to investors could also choose to do so by presenting their information in Spanish even if they chose to not translate the information in English.

Table 1: Summary of Companies Analyzed

This table includes a summary of all the companies analyzed. All company information was pulled from the local stock exchange, and it includes only companies listed as of December 31, 2013. Companies are not included in the sample if they were temporarily or permanently delisted from the exchange for not meeting requirements.

Country	Number of Companies	Companies with a Website (%)
Brazil	525	475 (90.48%)
Mexico	142	125 (88.03%)
Argentina	98	73 (74.49%)
Chile	252	202 (80.16%)
Columbia	80	70 (87.50%)

Table 2: Summary of Sample Companies with Websites in English and Spanish

This table shows a summary of the sample companies that have a website in English. Companies without websites in English were not included in the final sample. Since local languages are unique to each country, a foreign investor would need to hire a translator in order to be able to understand information disclosed in the local language. Thus, a company that wishes to make information easily accessible to investors would choose to do so by presenting the information not only in the local language, but also in a language of wide international circulation such as English.

Country	Number of Companies with a Website	Companies with a Website in English (%)	Companies with a Website in Spanish (%)
Brazil	475	271 (56.95%)	77 (16.19%)
Mexico	125	86 (69.01%)	125 (88.03%)
Argentina	73	36 (48.98%)	73 (74.49%)
Chile	202	67 (33.33%)	202 (80.16%)
Colombia	70	34 (48.75%)	70 (87.50%)

Research Findings and Discussion

As discussed earlier, researchers agree on the role of disclosure within a good corporate governance structure. Prior studies show that good corporate governance generally leads to lower equity risk premia and a lower cost of equity, and that investors in emerging markets favor countries with disclosure practices. In addition, high standards of good governance have been shown to be crucial in emerging economies as evidenced by investors willingness to pay a premium for emerging markets companies that practice good corporate governance (Newell and Wilson, 2002).

National securities regulators in each Latin American country oversee regulatory requirements, including minimum disclosure standards, which require issuers in the region to meet their respective stock market listing regulations. In this paper we focused on the disclosure practices employed by companies through their websites. Our hope was to find improved corporate governance practices for the Latin American companies. However, as the data summary shows, corporate governance disclosure practices remain weak despite national efforts in this area. Firms in these countries continue to disclose sporadic information through Internet sources. For example, only 31.72 percent of the 1097 companies analyzed have websites in the company's local language, and about 25 percent have a website in English.

Table 3: Summary of Disclosures for Sample Analyzed

This summary shows a summary of information disclosed by companies through their websites. Information was pulled from those websites translated in English. Due to the fact that the local languages are unique to each country, a foreign investor would need to hire a translator in order to be able to understand information disclosed in the local language. As this would be very costly to them, investors would likely choose to read the companies disclosures as presented in a language of wide international circulation such as English. Companies wishing to make information easily accessible to investors would choose to present the information both in the local language, and in a language of wide international circulation such as English. Percentages for disclosure columns are calculated based on the sample size for each country.

Table 3: Summary of Disclosures for Sample Analyzed

Country	**Number of Companies with Website in English**	**Companies Disclosing Chairman of the Board (%)**	**Companies Disclosing Financial Reports (%)**	**Companies Disclosing Corporate Governance Policies (%)**
Brazil	271	120 (44.19%)	135 (49.90%)	0 (0.00%)
Mexico	86	41 (47.89%)	52 (60.56%)	0 (0.00%)
Argentina	36	36 (100.00%)	12 (33.67%)	0 (0.00%)

Chile	67	17 (25.00%)	17 (25.40%)	0 (0.00%)
Colombia	34	13 (38.75%)	13 (40.00%)	0 (0.00%)

The data shows that companies use websites to disseminate information to the public, with companies in Brazil appearing to use websites more extensively than the rest. In-depth analysis of websites content, however, shows limited disclosures of material information. For example, financial statement information is mostly unavailable, which would make it very difficult for foreign investors to collect and interpret any sort of financial information due to the lack of disclosure made by firms.

The overall evidence suggests that the corporate governance frameworks of several Latin American markets have seen improvements in recent years despite poor performance by individual firms. For example, Chile requires issuers to provide detailed reports regarding their corporate governance practices. In Brazil, issuers now disclose detailed information regarding all agenda items, including board elections and binding remuneration proposals. In addition to federal corporate law, Brazilian issuers are also subject to the regulations of their stock market listing segments. For example, the Sao Paulo Stock Exchange (BM & FBovespa)[*] includes three voluntary listing tiers with increasing corporate governance standards for each level with the highest listing segments requiring, among others, minimum levels of board independence, the separation of chair and CEO roles, and tag-along rights for minority shareholders.

Despite improvements, out data shows that the disclosure record in Latin America is concerning. For example, majority-independent boards are very rare across the region. Brazil is the only market in the region in which timely disclosure of director nominees represents market practice. Although Brazilian law requires disclosure of management nominees prior to the meeting, minority shareholders are able to present the names of their nominees up to the time of the meeting. These rules were designed to minimize restrictions on minority shareholders, however they have a negative impact on international institutional investors who often submit their voting instructions in the absence of complete nominee information.

The voting rights of international institutional investors are also often limited in Latin America. For example, Mexican companies may divide their capital into several classes of shares with special rights for each of the shares, and voting rights for certain classes are restricted to Mexican nationals. With the exception of companies listed in the Novo Mercado, which are required to maintain a single class of shares, most Brazilian companies divide their share capital between common and preferred shares. Typically, common shares confer voting rights and preferred shares do not, although preferred shareholders have the right to vote on specific matters and under certain conditions.

[*] Bovespa's Novo Mercado Listing Rules, Mar. 2008. (Source: BM&FBOVESPA website as of 22 January 2015).

The disclosure practices shown are likely to be linked to the countries approach to enforcement of investor protection and securities market regulations. One could also argue that the corporate governance practices in Latin America are still weak due to the influence of grupos, diversification, and volatile macroeconomic environment. Latin American countries are characterized by highly concentrated ownership structures, slow local procedures and corruption. It is very likely that these factors explain the weak disclosure and transparency practices documented above. For example, concentrated shareholdings may undermine the political will to enforce existing rules and regulation or prevent corporate governance reforms from being implemented. Large controlling owners may tend to get involved in politics in order to influence the legislative and regulatory processes and the enforcement of adopted laws and regulations. Furthermore, firms controlled by large majority shareholders may be reluctant to increase disclosure or to push regulators to enforce disclosure requirements in order to avoid the high indirect costs of disclosure that are associated with giving information to rivals. As insiders cannot be challenged, the market for corporate control will likely function poorly and board activism will be unsuccessful in challenging the majority owner.

Current practices in Latin America support literature suggestions that the needs of management, and not merely investors, play a critical role in external financial reporting (Sauerwein, 2014). However, Latin American governments are becoming increasingly aware of the need for Latin American companies to improve disclosure and transparency practices. Such practices contribute to improving the overall standards of corporate governance. However, Latin American governments must also develop and implement effective monitoring and enforcements mechanisms, to ensure that shareholders have information to analyze and evaluate information on the governance structure of the company, how corporate decisions are taken, and what checks and balances are in place to ensure equitable treatment. Such enforcement mechanisms have proven successful in the case of Central and Eastern European economies. For example, Berglof and Pajuste (2003) showed that the strict regulatory mechanisms aimed at investor protection from management and large blockholder fraud adopted by Poland and Hungary led to almost 100 percent of the firms listed in these two countries disclose information through a website, with 66 percent in Hungary and 80 percent in Poland also having an English website.

Timely and detailed disclosure prior to shareholder meetings remains a significant concern across most of Latin America. Shareholders need access to information in order to make rational value-adding decisions, and enforcement must be in place in order to insure the information provided to investors is comprehensive and comparable. Laws requiring better disclosure to investors are in place, however some countries allow the withholding of material “reserved” information from the public. For example, securities regulators and stock exchanges in Brazil and Colombia require public companies to make announcements regarding material acts or facts that may affect the market value of their securities. However, this information may be withheld if management feels comfortable that the disclosure would be detrimental. Officers of the company may request a waiver from this obligation from the securities regulator, on grounds that the information would injure or put at risk the legitimate interests of the company.

In Mexico, the quality, quantity and delivery of disclosed information have improved, and financial reporting now follows with the U.S. model. Financial statements in annual reports must be “certified,” management must attest to the financial statements’ accuracy, however enforcement has, until recently, focused on formal issues rather than content. It is also unclear how much value CEO certification has in countries where the board typically represents the controlling shareholders. The already existing liability of the board with regard to financial statements may be more meaningful than any certification by management.

Except Brazil and Peru, most Latin American countries markets require issuers to establish audit committees, but the independence requirements vary. Furthermore, in Brazil, it is uncommon for issuers to create board committees with specific areas of oversight. Even those Brazilian issuers listed on NYSE do not have an audit committee. The Securities and Exchange Commission grants exemptions to foreign issuers and considers the Brazilian fiscal council, a corporate body lying outside of the board of directors, to be a valid substitute for an audit committee for purposes of the Sarbanes-Oxley requirements.

The division of responsibilities within companies must be well delineated and provisions must be put in place to minimize conflicts of interest. Board committees should have clearly defined responsibilities, especially in the case of audit committees. If the audit committee members have the necessary qualifications and the corporate governance framework can ensure the independence of its members, then less stringent external checks and balances are necessary to supervise the audit process. If, on the other hand, the audit committee does not fulfill this role, which is the case in most Latin American countries, then clear rules to avoid potential conflicts of interest of the external audit are necessary. These rules include mandatory detailed disclosure of audit and consulting fees in the annual report, the prohibition to simultaneously provide certain consulting services to the audited firm and/or mandatory rotation of audit firms or partners.

Conclusion

Overall, the investor community has a mixed perception of the quality of financial reporting in Latin America. It is imperative for these countries to continue to work toward educating society about the importance of increased transparency and disclosure about what managers and controlling owners do, and how they reward each other. Better disclosure and transparency could help companies overcome some of the poor image issues that companies in these countries face. Securities regulators should act as a catalyst that helps Latin American companies improve. Specifically, they should continue to strengthen their capacity to monitor disclosure and to enforce corporate governance provisions.

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