

IN A SURPRISING SHOWING, THE VALUE OF M&A activity in Brazil rose to \$61.77 billion in 2017. While still fairly low by global standards, that number marks a 33 percent increase over 2016.

The catalyst behind that jump was the nation's famous "Lava Jato," or "Car Wash," investigations into corruption. Large Brazilian groups under pressure from the probes were forced to sell major assets as their financing options became scarce.

Some of these deals naturally represented great opportunity for buyers in terms of valuation. But some also came with a fair share of risk, as they may still hold undocumented liabilities, or carry legacies from historically poor governance structures.

These deals and the probes themselves have heated up the discussion about corporate ethics in Brazil, highlighting the importance of the supervisory role of boards and the identification of risk not only in M&A transactions but in any capital allocation decision. At the center of that discussion are Emilio Carazzai and Heloisa Bedicks, respectively the former Chairman and General Superintendent of the Instituto Brasileiro de Governança Corporativa, a leading authority on corporate governance standards in the country.



GOVERNANCE Emerges from the "CAR WASH"

In 1995, when IBGC was created, one of the first issues the founding group had to deal with was the proper Portuguese translation for "governance." At that time, Mr. Carazzai and Ms. Bedicks say, board meetings at most companies were mere periodic lunch meetings, a leisure activity for a group of gentlemen to discuss everything but corporate issues. Meeting minutes were written in advance to be signed afterward, just as a formality.

Fast forward more than 20 years to the present day: The Lava Jato probes have made "governança corporativa" the phrase of the moment. The investigations started in 2014 and are the biggest ever into corruption in Brazil. However, according to Mr. Carazzai, the growing talk about governance has as much to do with the groundwork that had already been laid regarding a shift of culture toward international best practices. Lava Jato only threw additional light on its importance.

Brazilian Institute of Corporate Governance officials **EMILIO CARAZZAI** and **HELOISA BEDICKS** talk to Brunswick's **TEREZA KANETA** about reforms in the culture of business leadership

"It is not fair to say that the evolution of corporate governance in Brazil was accelerated due to Lava Jato," he says. "The revised fifth edition of IBGC's Corporate Governance Best Practices Code was published in November 2015, but the *first* one was published in 1999. Many other developments have assured the dynamism of governance-related themes in Brazilian capital markets, which would have happened with or without Lava Jato."

Among these were three significant initiatives: the Capital Markets Investors Association Stewardship Code for Responsibility of Institutional Investors; the Brazilian Association of Private Pension Funds Investment Code; and the reform of "Novo Mercado" guidelines starting in 2010 (Novo Mercado is the listing segment in the Brazilian Stock Market that includes companies with the highest standards of corporate governance, created in 2000). According to Mr. Carazzai, these follow a larger trend in Brazil.

"It's not a coincidence that Brazil has the most advanced capital markets in the BRIC countries (Brazil, Russia, India, China) or other Latin American countries," he says.

Still, those improvements on their own weren't enough. Some companies listed among the Novo

Mercado were later found to be targets of the Lava Jato investigations.

“Many companies have complied only in appearance,” Ms. Bedicks says. “On the surface, they had adopted all the best practices in terms of processes and structures. But the true essence, which pertains to companies’ culture, was not there. Lava Jato was a reality check for everyone – it highlighted the importance of strong board supervision and the importance of cultural change in Brazilian companies.”

Mr. Carazzai agrees, saying an emphasis on audits, governance rules and compliance requirements can only go so far – the culture itself has to change.

“The problem is only corrected by ethical behavior,” he says. “When you impose a regulation, you only create one more specialist in circumventing that regulation. What you have to do is to educate, pre-empt and mitigate. Fostering better practices, implementing strong supervision and severe punishment for wrongdoers will all result in better outcomes.”

TEREZA KANETA is a Partner in Brunswick’s São Paulo office. Former head of MZ Consult Latin America, she participated in 95 percent of the IPOs in Brazil between 2004 and 2012.

Arguably, the most significant outcome of Lava Jato is the realization that even “big shots” may be held accountable for the wrongdoing. The great surprise for Brazilians was not the exposure of the systemic unethical private-public relationships, but the fact that for the first time in history several high-profile businessmen, politicians and influential intermediaries involved in the schemes actually ended up in prison.

This change in the perception of risk and higher culpability for non-transparent decisions has made companies more vigilant. Pressure not only from boards and investors, but also from other relevant influencers have shaken companies to the core, and they are adapting – learning to engage and establish constructive conversations with all their stakeholders about ethical, environmental and social responsibility issues.

Both Mr. Carazzai and Ms. Bedicks agree this has resulted in permanent changes, at least in the private sector. As companies put their heads over the parapet, they are also learning to defend themselves from detractors, and this process leads to increased transparency.

“When a company decides on an investment or divestment, it should present itself in the most transparent way possible. Clever companies should maintain a dialogue with markets and society in general. So, in that regard, I do not see them falling back into old habits,” says Mr. Carazzai.

Ms. Bedicks expresses a cautious optimism. “Private companies have woken up to the importance of good governance to create sustainable value. The era of ‘leisure lunch board meetings’ are definitely over; companies understand the need for strong boards. What we see is that the pressure comes from its own board members; peer pressure has been elevating the standards of their own work.”

Overall, Ms. Bedicks believes there is still a long way to go for a broader cultural change, and she expects to see state-controlled companies also reforming governance and increasing transparency. Mr. Carazzai adds that more work needs to be done to build on the progress that’s been made.

“Our work at IBGC focuses on making sure all the advances in corporate governance are successful in the long term,” he says. “Significant advances inevitably produce reactive opposing forces – it happened in the implementation of Brazilian Corporate Law in 1976, and in the creation of Novo Mercado in 2000. The journey of governance is not a straight line. Resilience is the key.”

CLEAN-UP TIME

A sprawling **BRAZIL PROBE** reeled in everyone from car wash employees to an ex-President

BEGUN IN MARCH 2014 as a money-laundering inquiry, Brazil’s Operation Lava Jato (“Car Wash”) grew into the biggest corruption probe in Latin America. The name came from a car wash facility in Brasília that was an early focus of the probe.

Ultimately, key figures from several major corporations, including Petrobras, and nearly every political party were implicated.

AFTERSHOCKS CONTINUE TO ROCK BRAZIL: Former President Luiz Inácio Lula da Silva, still one of the country’s most popular politicians, was sentenced in April to 12 years in prison for corruption, even as he was ahead in the polls for the upcoming election. He is so far the highest profile figure imprisoned in the probe.

LULA DA SILVA disputes the charges and turned himself over to police only after a dramatic standoff involving thousands of supporters. His cell is in the southern city of Curitiba, in the same police headquarters where the Lava Jato probe is based.

The probe resulted in some impressive **NUMBERS:**

188
CONVICTIONS

305
PEOPLE
INDICTED ON CRIMINAL CHARGES

11.8
BILLION DOLLARS
IN FUNDS, INCLUDING FINES, RECLAIMED