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LIST OF ABBREVIATIONS

ADR	American Depositary Receipt
ANBID	National Association of Investment Banks
bil	billions
Bovespa	São Paulo Stock Exchange; also short for BM&FBovespa
BM&F	Brazilian Mercantile Futures Exchange
BM&FBovespa	Bolsa de Valores, Mercadorias & Futuros de São Paulo
BRIC	Brazil, Russia, India, China
BVRJ	Bolsa de Valores do Rio de Janeiro
CEO	Chief executive officer
CVM	Brazilian Securities and Exchange Commission
EVA	Economic value added
GDP	Gross domestic product
IAS	International Accounting Standards
IBGC	Brazilian Institute of Corporate Governance
IFC	International Finance Corporation
IGC	Special Corporate Governance Stock Index
IMF	International Monetary Fund

IPO	Initial public offering
MICEX	Moscow Interbank Currency Exchange
MICEX SE	MICEX Stock Exchange
mil	millions
OEDC	Organisation for Economic Cooperation & Development
ROSC	Report on the Observance of Standards and Codes
RTS	Russian Trading System
SPO	Secondary public offering
USD	US Dollar
US GAAP	United States Generally Accepted Accounting Principles
WTO	World Trade Organization

1 Introduction

1.1 Problem Definition and objectives

What used to happen quietly behind closed boardroom doors is now subject of considerable public interest: Corporate Governance, a rising star on the economic sky.

Over the last decades, the interest on this issue increased tremendously, making it the main topic of various discussions especially in the capital markets all over the world. Various accounting scandals in big international corporations, billions of deficits of important American investment banks in 2007 and 2008, the presence of excessive manager salaries and the business activities' orientation of shareholder value maximization have created a lot of mistrust and doubt about the current organization of the private sector. Efficient corporate governance has become the key ingredient of a good business management.

Policy makers are now more conscious of the contribution of good corporate governance to financial market stability, investment and economic growth. Several studies have been conducted, showing that good corporate governance practices have led to significant augmentations in economic value added of companies, higher productivity, and lower risk of systematic financial failures for countries.¹ Companies also realize the positive effect good corporate governance has on their competitiveness.² Also investors – especially collective investment institutions and pension funds acting in a fiduciary capacity – understand the role they have to play in guarding good corporate governance, thereby supporting the value of their investments.

¹ ROSC (2005)

² OECD (2004), p.3

Economies of today show that the interest in corporate governance goes beyond that of shareholders in the achievements of individual companies. Companies play an essential role in our economies. Private sector institutions manage personal savings and secure retirement incomes increasingly through the mutual funds industry. That is why good corporate governance is important to broad and growing segment of the population.

What is corporate governance?

Like it is with almost all economic issues, it is impossible to find one single answer, or one generally accepted definition of corporate governance. Depending on the perception of the author and the area of application, interpretations differ³ but, basically, it can be seen as a system by which business corporations are directed and controlled.⁴ There are two main directions of concepts, the shareholder value and the stakeholder approach. Both of them will be presented later on.

The purpose of this exposition is to describe the development and existence of corporate governance in the capital markets of Brazil and Russia and to analyze how it affected the performance of their stock exchanges. Especially in emerging economies where the legal system is often weak and shareholder protection very little or not existent, corporate governance becomes more and more important. When the legal institutions do not do a good job, the corporation has to make some effort at its own.

Giving an example of a new, innovative corporate governance system, we will look at Brazil's Novo Mercado and will analyze how successful it was and still is. Despite the limitation to implement certain improvements through legislative reform, the Brazilian stock exchange managed to establish a system of voluntary compliance with good corporate governance practices. What probably would not work out in every emerging country seems to have

³ Wentges (2001), p.73-74

⁴ Cadbury (1992), p.15; cited in Clarke (2007), p.2

been a great success in Brazil. But since every market has its own environment and political conditions, the same system cannot be applied everywhere. Russia, as we will see, has already made a lot of improvement concerning its corporate governance but it still seems hard to implement new systems into the capital market. In a country still marked by a powerful oligarchy it can be challenging to change the standards. Corporations have to be convinced of the benefit they could achieve by altering corporate governance requirements.

Before starting with the topic of corporate governance, a short overview of the composition of the work will be given to the reader.

1.2 Structure

The first part of the work deals with the term corporate governance in general, its origin and development as well as its principles recommended by the Organization of Economic Co-operation and Development (OECD).

In the following section, the Brazilian economy and its capital market are described, going more into detail about the São Paulo Stock Exchange and how it implemented the Novo Mercado, a listing segment which was implemented to increase corporate governance standards at the Brazilian stock market. The development before and after this implementation will be illustrated.

The next part gives an insight into the Russian economy and the situation at its capital markets as well as the corporate governance environment.

Subsequently, the structure and development of the Moscow Interbank Currency Exchange, Russia's most important stock exchange, is explained and important results of the last decade are shown.

In the fifth part, the Brazilian and the Russian capital markets will be compared. We will look at the differences and similarities between them and talk about one important question: would an implementation of a special corporate governance system like Brazil's Novo Mercado also work out in the Russian capital market?

This topic is continued in the sixth part, where I talk about future prospects and recommendations for good corporate behavior in the two emerging economies.

In the last part of my work I will give a short a summary about the most important aspects of the covered subject and end with my conclusion about the issue of corporate governance.

2 Corporate Governance

2.1 Definition

Originally the term *corporate governance* is derived from ancient Greek and Latin: *corporate* comes from the Latin verb *corporare*, which means to form into one body. Therefore, a corporation is a body or group of people that act as one unit. The word *governance* is derived from the Greek term *kybernao*, which means to steer, to guide, to act as a pilot.⁵ So literally, the composition of the two words means guiding a group of people.

In terms of economic terminology, corporate governance is the process of protecting the legitimate interests of stakeholders involved with the corporate entities.⁶ It is related to the relationships among the management, the Board of Directors, controlling shareholders, minority shareholders and other stakeholders.⁷ Its primary aim is to create the right incentive to allocate the resources to their most efficient uses and to provide transparency and accountability of business activities. The challenge is to align the interests of individuals, corporations and society as nearly as possible and therefore increase trust of all stakeholders.

As mentioned before, there are a lot of different interpretations. Zingales, for example, defines corporate governance as *the complex set of constraints that shape the ex-post bargaining over the quasi-rents generated by a firm*.⁸ Based on the view of a firm as being a nexus of incomplete contracts, he claims that quasi-rents, which are the difference between what two parties of a contract generate together and what they could obtain in the marketplace, cannot be perfectly allocated ex-ante. Therefore, room for bargaining is

⁵ Clarke (2007), p.1

⁶ McGee (2008), S.244

⁷ ROSC (2005)

⁸ Zingales (1997), p.4

created. The role of the corporate governance mechanisms is to set conditions for the bargaining so that quasi-rents can be distributed in a right way.

Shleifer and Vishny give another interesting interpretation. They understand corporate governance as a system that deals with the ways in which suppliers of capital to corporations assure themselves of getting a return on their investment.⁹ Since they do not control the firm themselves, they depend on the performance of the management and underlie the risk of opportunistic behavior. This conception is based on the agency problem, which will be discussed in the next section.

2.2 Development of corporate governance

Although the idea of corporate governance was known long before the 20th century, its necessity was first realized in 1930s, when people during the industrial revolution and after the Wall Street Crash of 1929 started to notice the deviation between interests of ownership and control. When Berle and Mean published their book “The Modern Corporation and Private Property” in 1932, the discussion about the efficiency of a separation of ownership and control started.¹⁰ In the following decades after this publication, various authors gave a lot of attention to this issue and tried to establish theories and explanations.¹¹ Soon corporate governance had become an important determinant of the distribution of economic power.¹² Today, in the time of an international economic crisis, the issue gained tremendous importance again. Bad corporate governance practices are blamed a lot for the failure of companies.

⁹ Shleifer and Vishny (1997), p.737

¹⁰ Jost (2001), p.79

¹¹ Holderness, Kroszner and Sheehan (1999), p.435

¹² Morck and Steier (2005), p.32

To understand the concept of corporate governance, it is important to be familiar with the agency theory, which explains the incentive schemes within corporations. The following point will cover this topic.

2.2.1 The Agency Problem

A lot of theories that try to explain corporate governance have its seeds in the principal – agent problem. Known as the Agency Theory, its essence is the separation of management and finance, or of ownership and control.¹³ It deals with the difficulties that come up under conditions of incomplete and asymmetric information between a principal, or stockholder, and an agent, or executive. This issue occurs especially in listed stock corporations, where a wide distribution of ownership makes it impossible for the shareholders to control the company themselves. Professional managers are hired to undertake the administration.¹⁴

The firm is seen as a nexus of constantly re-negotiated contracts by individuals each trying to maximize their own utility. Investors need the manager's specialized human capital to generate returns on their funds.¹⁵ They sign a contract about what to do with the investments and how to divide eventual returns. Since they can never cover all possible situations and future contingencies due to uncertainty, complete contracts are technologically infeasible.¹⁶ Therefore, the agent would still have opportunities to act in his sole discretion. Managers and financiers have to allocate residual control rights to define who makes the ex-post decisions in situations not specified in the contract.¹⁷ Usually the managers end up with extensive residual control rights because the financiers aren't qualified enough and sometimes even not

¹³ Shleifer and Vishny (1997), p.740

¹⁴ Schadeck (2006), p.6

¹⁵ Alchian and Demsetz (1972); cited in Clarke (2007), p.23

¹⁶ Shleifer and Vishny (1997), p.741

¹⁷ Grossman and Hart (1986), p.716

interested in exercising their rights. As a consequence there is a lot of room for discretionary allocation of funds for the agent. This has to be limited through corporate governance mechanisms.

To assure that the agent acts in the principal's interests, the principal has to control the agent. This comes along with costs, the so-called agency costs.¹⁸ There are three types of agency costs: costs of monitoring by the principal, bonding costs by the agent, and the residual loss that arises due to divergence between the agent's decisions and the principal's interests.¹⁹ Basically, if explaining it with the agency theory, the aim of all corporate governance instruments is to reduce those agency costs by creating equilibrium of information through more transparency and by giving the executives incentives to act in the shareholder's interest. Its mechanisms are ways to deal with the agency problems between managers and shareholders and between controlling shareholders and minority shareholders. They aim to assure that minority shareholders' rights are not taken away, managers' activities are monitored, and poorly performing CEOs are replaced.²⁰

Due to national, regional and cultural differences, various approaches to business formation and the corresponding structures have evolved different corporate governance orientations. The German-Japanese or network-based system reflects a stakeholder approach to corporate governance, since shareholders do not possess the preeminent position they do in the Anglo-American or market-based system, which relies primarily on agency theory.²¹

The discussion on corporate governance theories has been polarized between two main directions: the shareholder perspective and the stakeholder perspective. These two contrasting approaches differ in how they understand

¹⁸ Posch (2008), p.14

¹⁹ Jensen and Meckling (1976), p.6

²⁰ Gibson (2003), p.233

²¹ McCathy, Puffer and Shekshina (2004), p.4

and justify essential questions regarding the purpose of the corporation and its governance. These concepts will be discussed in the following parts.

2.2.2 The Shareholder value concept

The model of the shareholder value arose in 1986, when Alfred Rappaport launched his book *Creating Shareholder value*. Although Milton Friedman already wrote about the idea of the concept much earlier²², Rappaport is still said to be its originator.²³

The shareholder value concept is characterized by its concentration on the financial success of the company. The only interest of business activities is to maximize profits and dividends. It is assumed that the increase in value is related to the manager's effort. The CEOs should only act in the shareholder's interest to get out the highest return possible.²⁴ All operations and investment strategies are chosen according to their value propositions to the owners. This concept is common in the Anglo – American region but has also been observed in many other countries including Australia and New Zealand.²⁵

In this perspective of corporate governance, its task is to discipline the management in a way that assures a behavior according to the shareholders' interests.²⁶

Because of its one-sided alignment towards the shareholders, people often refuse the "capitalistic" shareholder concept. They claim it to be monocausal and extremely shareholder-friendly.²⁷ However, those prejudices are not

²² Friedman (1970)

²³ Malik (2008), p.47

²⁴ Malik (2008), p.139

²⁵ Clarke (2007), p.129

²⁶ Wentges (2001), p.86

²⁷ Schiltknecht (2009), p.31

always justified. An analysis of the economic development of the last 200 years show that the maximization of the shareholder value is the only reasonable objective of business activities and that it supports the development of new, better products, promotes economic efficiency and therefore increases society's welfare as a whole.²⁸

However, the continued criticism about the side effects of the shareholder value approach led to a new approach, which will be presented in the next point.

2.2.3 The Stakeholder Approach

The term stakeholder is an analogy to the word shareholder²⁹ and includes every person or group that stands in any relationship with the company including employees, customers, suppliers, and the community.³⁰

Unlike the shareholder value concept, the stakeholder approach considers the interests of not only shareholders but also all participating stakeholders. It is built on relationships with a large range of stakeholders, and understands the corporate mission as the creation of long-term values for all stakeholders.³¹ An important aspect is the social responsibility of the firm, whereby society as a whole is a stakeholder.³² The aim of corporate governance from this point of view is to ensure that firms are run in such a way that society's resources are used efficiently.³³

²⁸ Schiltnknecht (2009), p.35

²⁹ Wentges (2001), p.93

³⁰ Monks and Minow (2004), p.50

³¹ Clarke (2007), p.9

³² Chilosi and Damiani (2007), p.2

³³ Allen (2005), p.165

The basic difference between the shareholder value model and the stakeholder approach is that the latter one considers the interests of all groups influenced by the company. So it is not only focused on the financial result for the owners, but tries to act in the best-balanced interest of all stakeholders.

Since every group has its own interests, it is close to unachievable to consider them all. Only one target function can be maximized at the same time.³⁴ This “harmony-model” is basically a nice idea, economically, however, - if one believes in Malik’s words - a disaster.³⁵ Vinten also claims that the stakeholder approach is incompatible with business because of the required consideration of everyone.³⁶

But opinions differ. Rivals of the shareholder value concept claim, that a profit maximizing strategy imposes various externalities on other stakeholder.³⁷ For example, if there were external factors like pollution, then the shareholder value concept would decide to only maximize the value of the firm and therefore might cause a misallocation of resources. If, however, the stakeholder approach were followed, the firm would change and produce only the socially optimal level of pollution.³⁸

The discussion of shareholder versus stakeholder approach goes still on and there is probably no one right concept. It always depends on the environment and also on the branch of business. Following the shareholder value concept does not necessarily exclude the possibility to also consider the interests of other stakeholders. Profit maximization is not always contrary to social responsibility. Sometimes taking externalities into account may actually contribute to bigger profits in the long run.

³⁴ Posch (2008), p.18

³⁵ Malik (2008), p.135

³⁶ Vinten (2001), p.37

³⁷ Chilosi and Damiani (2007), p.11

³⁸ Allen (2005), p.165

For the future, I think, where business is getting more global and more complex, the stakeholder concept will be the better concept. As can be seen in the actual crisis also in the USA, the demand for more regulations on the financial market is increasing. More regulations result in more stakeholder and less shareholder model influences. Or formulated in a different way: the stakeholder concept will also be the best model for the shareholders.

The different conceptions vary in aspects of corporate law and have different rules determining the framework of corporate life and capital markets.³⁹ However, the basics of good corporate behavior are the same in many parts of the world. The following point talks about the common standards of the OECD.

2.3 OECD Principles of corporate governance

In 1999, the ministers of the Organisation for Economic Co-operation and Development (OECD) endorsed the OECD *Principles of Corporate Governance*. Since then they have become an international benchmark for policy makers, investors, corporations and other stakeholders all over the world. They have advanced the corporate governance agenda and provided specific guidance for legislative and regulatory initiatives in both OECD and non-OECD countries.⁴⁰

The following principles offer non-binding standards and good practices as well as guidance on implementation, which can be modified to the specific circumstances of individual countries and regions.

³⁹ Chilosì and Damiani (2007), p.2

⁴⁰ OECD (2004), p.3 - 25

OECD Principles of Corporate Governance

- **Ensuring the Basis for an Effective Corporate Governance Framework**

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

- **The Rights of Shareholders and Key Ownership Functions**

The corporate governance framework should protect and facilitate the exercise of shareholders' rights.

- **The Equitable Treatment of Shareholders**

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

- **The Role of Stakeholders in Corporate Governance**

The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

- **Disclosure and Transparency**

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

- **The Responsibilities of the Board**

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

OECD (2004)

Since corporate governance typically consists of elements of legislation, regulation, self-regulatory arrangements, voluntary commitments and business practices that are the results of a country's specific circumstances, history and tradition, their implementation and interpretations vary a lot throughout the world.

Corporate governance issues are particularly important in developing and emerging economies, since these countries do not have a strong, long-established financial institution infrastructure to deal with problems concerning the direction and control of business corporations.⁴¹

Before concentrating on the Brazilian corporate governance and capital market, the importance and development of corporate governance in emerging countries will be shortly discussed in the following point.

2.4 Corporate Governance in emerging countries

In the twelve years since the Asian crisis, the economic and financial landscape in emerging countries has been changed a lot. Countries have empowered their financial markets and developed the infrastructure needed to promote issuance and investment in long-term, fixed-rate, and domestic-

⁴¹ McGee (2009), p.3

currency-denominated debt securities. Capital markets have become more liquid and attracted international investors.⁴²

As one can see in Figure 1, the corporate governance quality (CGQ)⁴³ has risen a lot since the late 1990s. The crisis in 1997 led to drops of the index worldwide, clarifying the need to strengthen corporate governance especially in emerging market economies where the damage was intense. The line of emerging economies is far beneath the one from advanced economies, but increasing constantly since 2001. Latin America made the biggest development, rising from the lowest Index in 1997 to even above the emerging countries' average in 2004. As will be shown in part four of the work, great progress happened especially in Brazil, probably thanks to the implementation of the Novo Mercado in the end of 2000.

Another interesting aspect that can be read from the chart is the fact that the higher the CGQ index, the lower is the reaction to economic instabilities. In the United States, for example, the Asia crisis didn't have any affect on the index while in Latin America there was a huge drop in the value. Of course there might also be other explanations for this reaction but a high corporate governance level has certainly a positive influence on the vulnerability to financial crisis.

⁴² Ananchotikul and Eichengreen (2009)

⁴³ The CGQ Index is measured by three components: the share of the 40 most important accounting items, a measure of earnings smoothing and a measure of stock price synchronicity. For details see Nicolo et al. (2006)

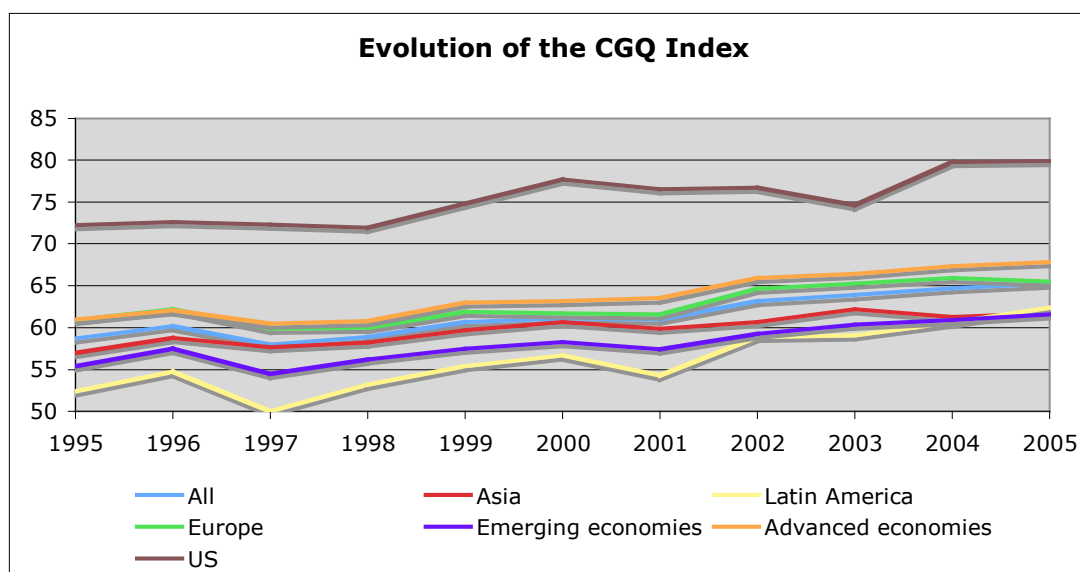


Figure 1: Evolution of the corporate governance quality
Source: own illustration adopted by Ananchotikul, Eichengreen (2009)

Being in need of capital and investments, a lot of developing economies started to realize that it could be of great advance to bother about good corporate governance. Improving it can serve a number of important public policy objectives. It makes it easier to obtain capital and helps to increase the share price. Some institutional investors have identified corporate governance as a main aspect affecting their willingness to invest in an emerging market.⁴⁴

Furthermore, good corporate governance reinforces property rights, reduces transaction costs and the cost of capital, and supports the development of the capital market. According to various studies, good corporate governance practices also lead to significant increases in economic value added of companies and a higher productivity. Also the risk of systematic financial failures can be lowered.⁴⁵ All this advantages can help emerging countries in developing their economy.

⁴⁴ Gibson (2003), p.231

⁴⁵ ROSC (2005)

2.4.1 The legal background

The legal tradition is an important factor in strengthening the financial sectors and influences the corporate governance significantly. As a result of colonization, today, legal traditions of the British law (common law) and the French civil law systems are observed in more than 80 percent of the countries worldwide.⁴⁶ Source of law in common-law countries are the legislation and the case law whereas in civil-law-countries the statute is decisive. Countries following the common law, like India, South Africa or Malaysia, show a better protection of investors than civil-law-countries like Mexico, Brazil or Japan. Therefore the capital markets and financial sectors are better developed and equity financing is more prevalent. As a consequence they have far more listed firms and more IPOs per inhabitant.⁴⁷

2.4.2 Policy reforms

In the last decades, many reforms regarding corporate law have already been undertaken in several emerging countries. Reforms such as the Sarbanes-Oxley Act in 2002, the Cadbury recommendations, and numerous other proposals were realized in response to corporate scandals to improve the corporate behavior standards.⁴⁸ Requirements concerning the independence of auditors, the role of the audit committee, a minimum of independent directors and other rules formulated to protect investors and the public, were introduced.⁴⁹ New structures of the private sector were established through the process of privatization and created the need for plenty regulations. In Rumania, for example, the privatization was accomplished by a broad distribution of free shares. As a consequence, the shareholders didn't see themselves as being the owners, and the companies didn't see them as

⁴⁶ Capaul (2003), p.5

⁴⁷ Leal and De Oliveira (2002), p.23

⁴⁸ Hermalin and Weisbach (2006), p.1

⁴⁹ Gallagher (2002)

investors. The result was a wide expropriation of minority shareholders. Continuous complains by shareholders finally led to the implementation of new regulations regarding shareholder rights protection.⁵⁰

Countries do policy reforms when they notice that something is “wrong”. But changing the rules is not enough. The adoption of new systems always comes along with different situations that have to be handled. In order to make the reform work, it must contain regulations that help the companies to adopt the changes without creating new conflicts.

2.4.3 High ownership concentration

When a country is characterized by a high stock concentration and poorly developed stock markets as it is, for example, in Latin America or Russia, one of the major corporate governance issues is the agency conflict between controlling and minority shareholders. Opportunistic behavior of controlling shareholders, who only want to maximize their interests, leads to an expropriation of minority shareholders.⁵¹ In countries where the legal system does not do a good job of protecting the rights of shareholders, concentrated ownership is more prevalent.⁵² Therefore, it is even more recommendable for firms in those countries to adopt good governance practices.⁵³ International investors hesitate to lend money or buy shares in corporations that do not subscribe to good corporate governance principles. Transparency, independent directors and a separate audit committee are very important. Some international investors will not seriously consider investing in a company in an emerging country that does not show these standards.⁵⁴ One important implication of this reluctance is that capital markets remain poorly developed.

⁵⁰ Capaul (2003), p.5

⁵¹ Rogers, Dami, Ribeiro and Sousa (2007)

⁵² Gibson (2003), p.233

⁵³ Klapper and Love (2004), p.706

⁵⁴ McGee and Preobragenskaya (2004), p.1

2.4.4 Related party transactions

Under ownership structures of high concentration and complexity, like there is in a lot of emerging countries, one family may own listed companies and private firms without the relationship of different parts of the business group being transparent. Minority shareholders might not even know that the controlling shareholder has any connection to the related firm. As a consequence capital assets can be used in related party transactions in the interest of the controlling shareholder creating a disadvantage for minority one. It is important that policymakers create clear rules concerning the approval of such transactions. In Chile, for example, the approval process already underlies a set of rules to guarantee proper disclosure and enable denial if the transaction seems detrimental to a certain amount of shareholders.⁵⁵

2.4.5 Courts vs. regulators

In a lot of emerging countries, courts are under funded, unmotivated, overloaded, not familiar with economic issues and sometimes even corrupt. There is often a lack of resources. In South Africa, for instance, courts are so overburdened that they cannot cope with business cases at all.⁵⁶ Under circumstances like this, an expansion of specialized regulators would be useful. Also an independent arbitration panel, like the Brazilian stock exchange uses, can be implemented to enforce the corporate law. In both cases, the institution should have the right to impose sanctions.

⁵⁵ ROSC (2005), p.6

⁵⁶ Capaul (2003), p.6

2.4.6 Firm-level corporate governance

Another innovative approach is to increase the company's alternatives and incentives for the voluntary implementation of standards and codes of corporate governance. The stock exchange of Thailand, for example, tried to encourage companies by offering a discount of listing fees to firms that implemented corporate governance standards.⁵⁷ It is also useful to offer different levels of corporate governance to choose from. By doing that, companies and investors can select the level that seems the most appropriate for their own risk profile. This approach enables an unconstrained mechanism to increase the corporate governance standards of a country. Brazil and Bucharest used this method. Because of the higher evaluation of companies performing under a stricter corporate governance level, other companies start to improve their practices as well to not be left behind in the competition.

2.4.7 Code of Best Practice

Alternative to legal regulations, which often insist only on basic requirements regarding corporate behavior, many countries have implemented so called "Codes of Best Practice". These are national rules that exceed those required by law and consist of voluntary principles tailored to the needs of each country. Often, they are part of the statute book like it is in Austria, for example. It can also be the case that the code is only obligatory for companies of a certain size or sector or only for listed companies. Sometimes it is extended by a so-called "comply-or-explain", or - a little modified - "apply-or-explain" mechanism. In those cases, companies are "allowed" to act not according to the code but when they do so, they have to give a plausible explanation why. Countries where this mechanism is common are, for instance, Bangladesh⁵⁸, Uganda⁵⁹ and South Africa.⁶⁰

⁵⁷ Capaul (2003), p.8

⁵⁸ Siddiqui (2009), p.17

⁵⁹ Musaali (2009), p.8

In general, changes in the system – no matter through which procedure - are always an interminable and complex process and need a lot of patience, negotiations and compromises. As we will see now in the example of Brazil, it is a tedious procedure but in the end the efforts usually pay off.

⁶⁰ Mallin (2007), p.251

3 Brazil and its economy

Characterized by ample and well-developed agricultural, mining, manufacturing, and service sectors, Brazil's economy exceeds that of all other South American countries and it is expanding its participation in world markets.⁶¹

With a population of 198.7 million people, Brazil is the sixth most populous country in the world. It is the world's tenth largest economy by purchasing power parity.⁶² Living conditions vary dramatically and also the income disparities are significant across the country, between metropolitan centers, non-metropolitan urban centers, and rural areas.⁶³

After a long period of state intervention, various regulatory reforms in the 1990s led to a move towards liberalization and privatization.⁶⁴ Important steps had to be taken in terms of competition policy. Economic openness, institutional reforms and the stabilization of inflation allowed by the Real Plan (Plano Real) created a more advantageous environment for regulatory reform.⁶⁵ The country wanted to attract investment, initiate further incentives for growth, and resolve some of the long lasting deficiencies of public provision. Some restrictions on foreign capital were abolished to relieve the state from high investment in and high expenditure especially on infrastructure industries.

⁶¹ The World Factbook (2009), www.cia.gov

⁶² The World Factbook (2009), www.cia.gov

⁶³ World Bank Country Study (2004), p.3

⁶⁴ OECD (2008), p.11

⁶⁵ OECD (2008), p.19

3.1 The capital market

The Brazilian capital market is catching up both in terms of size and depth with markets in other middle-income countries like Chile or India.⁶⁶ Since structural reforms in 2000, Brazil's capital market has distinguished itself through a uniform processing- and storage-system where stock markets are based on division of labor.⁶⁷ The nine stock exchanges signed an agreement to concentrate the trading and listing of publicly held companies on the São Paulo Stock Exchange, Brazil's biggest exchange, while assigning the other exchanges with promoting for the financial market in their region.⁶⁸ On the Rio de Janeiro Stock Exchange, the second largest exchange in Brazil, only government bonds are traded. The exchanges remained legally independent but appear to the outside a one trading center.³⁹

The capital market is characterized by a high ownership concentration. Minority shareholder protections are the main issue concerning corporate governance in Brazil. Historically, control has been maintained by limiting ownership of voting shares to family members only. Today, a predominant part of the trading volume is still represented by non-voting shares.⁶⁹

Brazil's law traditionally follows the French civil code, which, as mentioned before, is known to be the worst regarding investors' rights protection.⁷⁰ In civil law systems, legal rules are set by legislatures and decisions by courts do not corporate into the law. Therefore, it is quite common that conflicting judge sentences ignore the jurisprudence. Consequently, if a corporate insider finds a way to expropriate outside investors without explicitly breaking the law,

⁶⁶ ROSC (2005), p.1

⁶⁷ Hügle (2001), p.218

⁶⁸ Santana (2008), p.7

⁶⁹ ROSC (2005), p.2

⁷⁰ Berghe (2002), p.154

he might be able to continue without fear of an unfavorable judicial decree.⁷¹ Due to Brazil's poorly developed legal environment, some corporations started to act in their own way to get the confidence and trust of investors.

In the context of this exposition, further consideration will only be given to the Bovespa, since the main interest of this work is the implementation of its corporate governance system.

⁷¹ Leal and De Oliveira (2002), p.23

3.2 BM&F BOVESPA

In May 2008, the São Paulo Stock Exchange (Bovespa) and the Brazilian Mercantile and Futures Exchange (BM&F) merged, creating the new BM&F Bovespa.⁷² Today, the so-called Bolsa de Valores, Mercadorias & Futuros de São Paulo is the forth-largest stock exchange of the Americas⁷³ in terms of market capitalization, behind NYSE, Nasdaq, and Toronto Stock exchange.⁷⁴

3.2.1 History

Created in August 1890, Bovespa and other Brazilian exchanges were official entities tied to the finance departments of state governance with brokers being appointed by the public sector. They were state-owned companies until 1965, when various reforms turned the Bovespa into a non-profit civil association.⁷⁵ In 1972, Bovespa was the first stock exchange in Brazil to introduce an automated system for the dissemination of information on-line and in real time, through a large network of computer terminals. In the 80s, a Private Telephone Operations System (SPOT) and an on-line service network for brokerage firms were implemented. Bovespa always intended to use highly advanced technology to facilitate all operations. In 1997, a new electronic trading system called the Mega Bolsa, was launched. Expanding the potential information trading volume was only one great benefit from this system, which made the Bovespa the most important trading center in the Latin American market. Two years later, Bovespa introduced two new systems called the Home Broker and After-Market systems, whose aim was to

⁷² www.bmfbovespa.com

⁷³ *Americas* are the lands of the Western hemisphere, containing of the continents of North and South America with their associated islands and regions.

⁷⁴ www.world-exchanges.org

⁷⁵ Santana (2008), p.5

ease the market participation for small and medium-sized investors.⁷⁶ The Home Broker system enables orders to be done directly through the brokerage firm's website on the Internet. The After-Market system offers evening electronic trading.

The average performance of the Brazilian stock market is indicated by the Bovespa Index, known as Ibovespa. It reflects the variation of Bovespa's most traded stocks. It is the current value, in Brazilian currency, of a theoretical stock portfolio constituted in 1968 by a hypothetical investment with a base value of 100 points.⁷⁷ Its aim is to reflect as close as possible the real configuration of the cash market operations on Bovespa.

3.2.2 Development until 2000

Due to the economic reforms of the 1990s, Brazil's capital market has received a significant inflow of foreign portfolio investment. During the whole first semester of 1997, Brazil's stock market enjoyed an upward trend with a spectacular rise of 93,4 percent within six months. Thanks to the economic reforms and the aggressive privatization program Brazil benefited from the perceived strengths of its recent stabilization.⁷⁸ However, the higher level of trading volume on Brazil's stock exchange did not hold up during successive crises after mid-1997.⁷⁹

The international financial crisis beginning in Asia in 1997 created speculative pressures in Latin America and slowed down growth rates in many Latin American countries. Brazil suffered from loss in investor confidence and shocks to intra-regional trade. Because of Latin America's dependence on

⁷⁶ De Medeiros (2005), p.2

⁷⁷ www.bovespa.com.br/indexi.asp

⁷⁸ <http://www.cvm.gov.br/ingl/public/publ/artigo2/bocarato.asp>

⁷⁹ Santana (2008), p.2

foreign capital to finance current account deficits, the region was very vulnerable to unexpected withdrawals of foreign capital.⁸⁰

At the end of the 1990s, Brazil's capital markets were less developed and representative of the country's economy. It was challenged with disastrous times.

As seen in the following two charts, Bovespa's performance was declining.

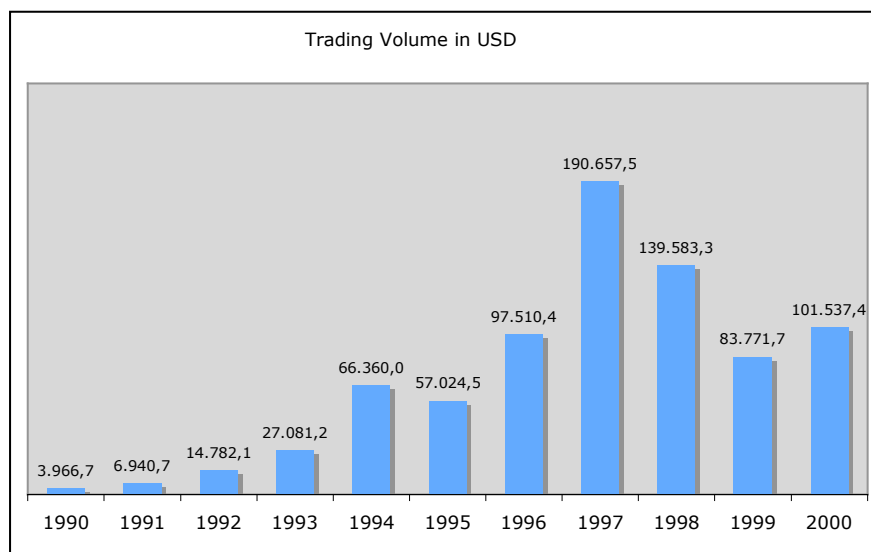


Figure 2: Bovespa's annual trading volume in USD millions

Source: www.world-exchanges.org

Compared to 1997, the total value of shares traded on the Bovespa dropped by 56 percent at the end of 1999. The downward movement of the Bovespa index also reflects the poor performance in those years. After the crisis in 1997, the Ibovespa dropped about 35 percent in two years.

⁸⁰ Langley and Bolling (1999), p.11

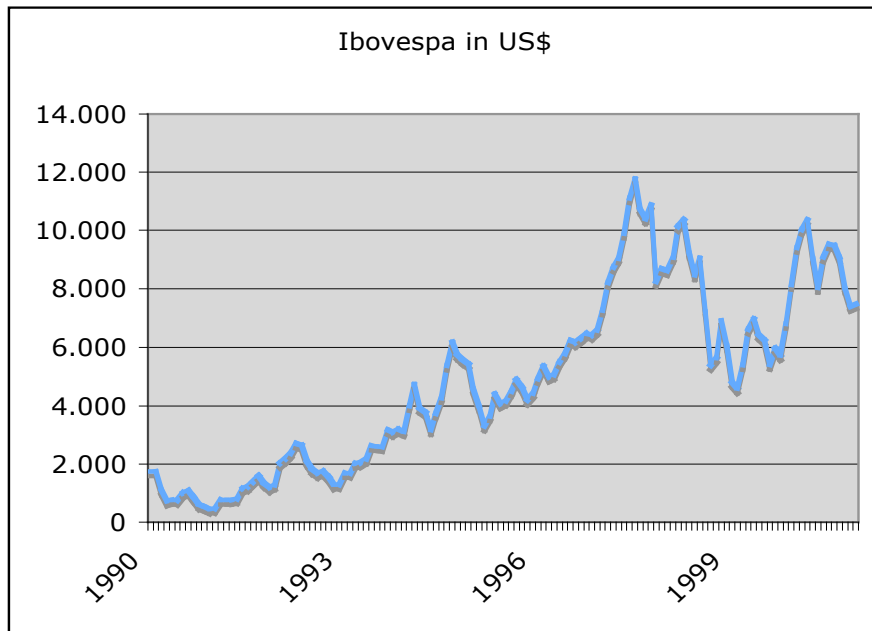


Figure 3: Bovespa Index in USD

Source: www.bovespa.com.br/indexi.asp

Looking at the performance of a stock market, one can interpret the economic situation as a whole. In 1997, Brazil had a current account deficit of more than \$30 billion, or nearly 4 percent of the country's gross domestic product (GDP).

3.2.3 The problems

During that difficult period, hardly any companies applied to list in the exchange. The Brazilian equity market was very weak at that time. Brazil's basic interest rate was, in real terms, the highest in the world.⁸¹ Its market liquidity has largely been exported to the American exchanges by the late 1990s. Because of low prices in the secondary market, many controlling shareholders removed their companies from the Brazilian market by going private.⁸²

⁸¹ Santana (2008), p.16

⁸² Santana (2008), p.5

Bovespa became aware of the importance of credibility as a factor in the market's attractiveness.⁸³ It hired a group of experienced professionals, which conducted a study to identify how to influence the market's attractiveness positively. Results pointed out the insufficiency of guarantees and protections for securities investors.

The legal system in Brazil didn't really do a great job protecting shareholders' rights. A huge part of shares were given out as preferred shares, which didn't have any voting rights but only the right to receive dividends. As a result, the companies were controlled by a small number of holders of voting shares. The Brazilian Corporation Law permitted publicly held companies to issue up to two-thirds of their capital of shares without voting-right. The majority of the remaining third, which in the end was only 17 percent of the stock, was able to control the company. In 2002, a legislative reform reduced the proportion between the two share types to 50 percent, but only for companies that went public after the adoption of this reform. There was still a huge misalignment between the interest of controlling and not controlling shareholders. Minority shareholders still suffered from unfair treatment and their powerlessness concerning the management of the company.

Since the legal environment could not be changed so easily, Bovespa started to think in an individual plan to increase its attractiveness. It had to be something that did not depend on major reforms or developments on the country's legal corporation structure.

Bovespa decided to establish its own listing rules to strengthen its credibility and to create more confidence among investors and companies. Perceived risk had to be reduced by generating safer conditions and more rights for all shareholders. Furthermore, incentives for companies to list in the stock market had to be created. All this could be achieved by a new, better corporate governance system.

⁸³ Santana (2008), p.8

3.2.4 Novo Mercado

In December 2000, Bovespa finally launched its new corporate governance instrument: the Novo Mercado (=New Market). It is a special segment of the Bovespa available to companies that choose to adopt high standards of corporate governance. It contains practices beyond those required by Brazilian law. The Novo Mercado was created as an implication of the assumption that a reduction in investor perceptions of risk would have a positive effect on share values and liquidity.⁸⁴ Bovespa thought this risk reduction could be achieved by offering additional rights and guarantees to shareholders and by narrowing the information asymmetry between the management and the market participants.

The most important innovation of the Novo Mercado, when compared to the legislation of that time, was the ban on the issuance of non-voting shares. It was assumed that, by protecting minority shareholders more effectively, companies would be able to raise capital at a lower cost.

Additionally, the so-called Market Arbitration Panel was created. It is a specialized alternative to the legal system whose aim is to resolve conflicts between investors and companies.

3.2.4.1 Listing rules

Bovespa created a series of standards of the behavior of companies, managers and controlling shareholders, which were considered as important for valuation of shares and other assets issued by the company. Three different levels of corporate governance rules were introduced, depending on the degree of commitment accepted by the company: Level 1, Level 2 and Novo Mercado, the highest level.

⁸⁴ Santana (2008), p.1

Companies listed in **Level 1** obligated themselves to the following transparency and stock dispersion rules:⁸⁵

- Maintenance of a free-float of at least 25% of the capital;
- Public offerings have to use mechanisms to favor capital dispersion;
- Improvement in quarterly reports, including the disclosure of consolidated financial statements and special audit revision;
- Monthly disclosure of trades involving equities issued by the company on the part of the controlling shareholders;
- Disclosure of an annual calendar of corporate events.

To be listed in **Level 2**, in addition to the obligations of Level 1, the company and its controlling shareholders must adopt and observe a much broader range of corporate governance practices and minority shareholder rights. The balance of rights among controlling and minority stockholders was accomplished by the following rules:⁸⁶

- Establishment of a two-year unified mandate for the entire Board of Directors, which must have five members at least, of which at least 20 percent shall be Independent Members;
- Disclosure of annual balance sheet according to standards of the US GAAP or IFRS;
- In case majority shareholders sell their stake, same conditions granted to them must be extended to common shareholders, while preferred shareholders must get, at least, 80% of the value/conditions (tag along);
- Voting rights granted to preferred shares in circumstances such as incorporation, spin-off and merger and approval of contracts between the company and other firms of the same holding group, when deliberated at general meeting.

⁸⁵ <http://www.bovespa.com.br/indexi.asp>

⁸⁶ <http://www.bovespa.com.br/indexi.asp>

- Obligation to hold a tender offer by the economic value criteria, in case of delisting or deregistration process;
- Admission to the Market Arbitration Panel for resolution of corporate disputes.

The **Novo Mercado** is the highest listing level and contained the strictest corporate governance practices. The main difference to the other two levels concerns the capital stock. Only common shares (voting shares) were allowed. Obligations for publicly held companies listed on Novo Mercado are:⁸⁷

- Public share offerings have to use mechanisms to favor capital dispersion and broader retail access.
- Maintenance of a minimum free float, equivalent to 25% of the capital.
- Same conditions provided to majority shareholders in the disposal of the Company's Control will have to be extended to all shareholders (Tag Along).
- Establishment of a two-year unified mandate for the entire Board of Directors, which must have five members at least, of which at least 20 percent shall be Independent Members.
- Disclosure of annual balance sheet, according to standards of the US GAAP or IFRS.
- Improvements in quarterly reports, such as the requirement of consolidated financial statements and special audit revision.
- Obligation to hold a tender offer by the economic value criteria, in case of delisting or cancellation of registration as publicly held company.
- Compliance with disclosure rules in trades involving securities issued by the company in the name of controlling shareholders.
- Some of these obligations must be approved at the General Shareholders Meetings and included in the corporate bylaws.

⁸⁷ <http://www.bovespa.com.br/indexi.asp>

The reason to offer different levels of commitment to corporate governance was to create alternatives for those companies that have preferred stocks in their capital stock but are willing to become more transparent and provide more guarantees to their investors. For many of them, two-thirds of their total capital was in preferred stock already outstanding. So obligating themselves to the requirements of the Novo Mercado would have meant a drastic change linked to high costs. Companies also feared to lose parts of their flexibility if committing to Novo Mercado's standards. That is why Bovespa created "softer" levels of corporate governance rules for companies that wanted to signal at least some commitment to good corporate governance without limiting their flexibility to organize their capital structure.

Companies listed in one of those levels are obligated to follow the listing rules. If a company, however, fails to comply the listing regulations, it can be subject to fines, suspension of shares from trading, and, in more serious cases, cancellation of its registration.

3.2.4.2 Implementation

When the new system was presented in the end of 2000, Bovespa expected that mainly new, publicly held companies would list in the new segment because of the great amount of now forbidden preferred shares the existing companies had. But the plans to go public were delayed because of the bad economic conditions of that time. In 2001 Brazil's economy suffered from a domestic energy crisis, the exacerbation of the Argentine crisis and the attacks on the World Trade Center in September. The following year was marked by the drastic devaluation of the *real* due to possible major political changes in Brazil.

The implementation of the Novo Mercado was a tough time, in which the Bovespa had to overcome several challenges. All efforts toward attracting new companies didn't seem to work out. The skepticism among companies

was too big. In the first year, no firms were listed on the Novo Mercado or Level 2, and there was no single IPO in whole Brazil.

But Bovespa finally got support from important partners. First, the Brazilian Institute of Corporate Governance (IBGC) assisted in publicizing and lending prestige to the Novo Mercado. Further more, the Brazilian Securities and Exchange Commission (CVM), a Brazilian pension fund agency, and the Brazilian Development Bank (BNDS) supported it by offering benefits for companies listed on the Novo Mercado or Level 2. Also the World Bank and the OECD helped to advance the initiative.

Another supporter of great importance was the National Association of Investment Banks (ANBID), who demanded the issuers of offers to be at a minimum registered in Level 1.

The Bovespa created the so called Special Corporate Governance Stock Index (IGC), which is designed to measure the return of a theoretical portfolio composed of shares only of companies that are listed on the Novo Mercado, Level 1, or Level 2. The index is calculated in real time, considering the prices of the last trades carried out on the cash market up until the moment of calculation.

3.2.5 Developments after implementation of the Novo Mercado

One year after the implementation there were 19 companies listed on Level 1, representing 14,39 percent of the total volume traded. There was no firm listed in Level 2 or Novo Mercado.⁸⁸

The first IPO on the Novo Mercado since the launch was finally achieved in February 2002. By the end of the year, there were two companies in the Novo Mercado segment, three in Level 2 and 24 in Level 1.

⁸⁸ Santana (2008), p.22

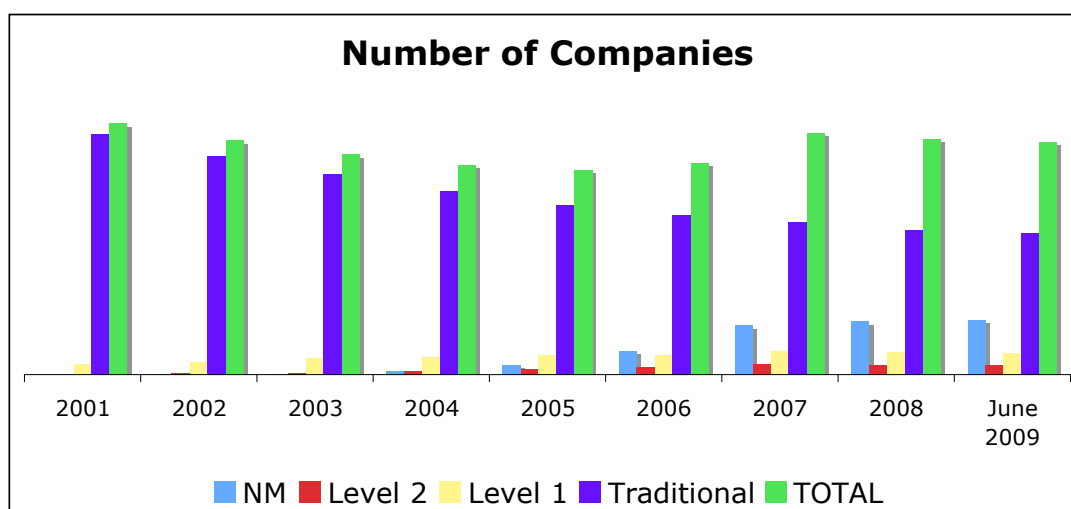


Figure 4: Number of listed companies⁸⁹

Source: www.bovespa.com.br

In 2003, once again, there was no new listing in the Novo Mercado or in Level 2, but at least some companies have been listed in Level 1. 2004 seemed to be the year of breakthrough of the special segments. The number of firms listed on the Novo Mercado started increasing constantly.

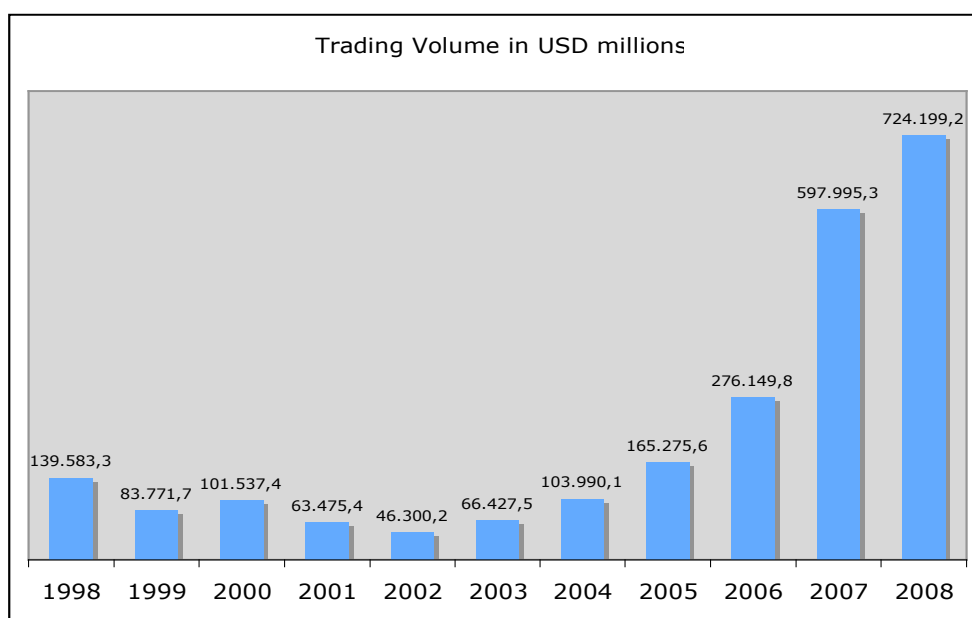


Figure 5: Bovespa's trading volume in USD millions

Source: <http://www.world-exchanges.org/>

⁸⁹ TOTAL includes foreign issuers

Also the total volume of shares traded on the Bovespa augmented rapidly. From 2004 to 2008 it increased by almost 600 percent. The positive development of the stock market is closely connected to the economic situation. From 2003 to 2007, Brazil ran record trade surpluses and recorded its first current account surpluses since 1992.⁹⁰

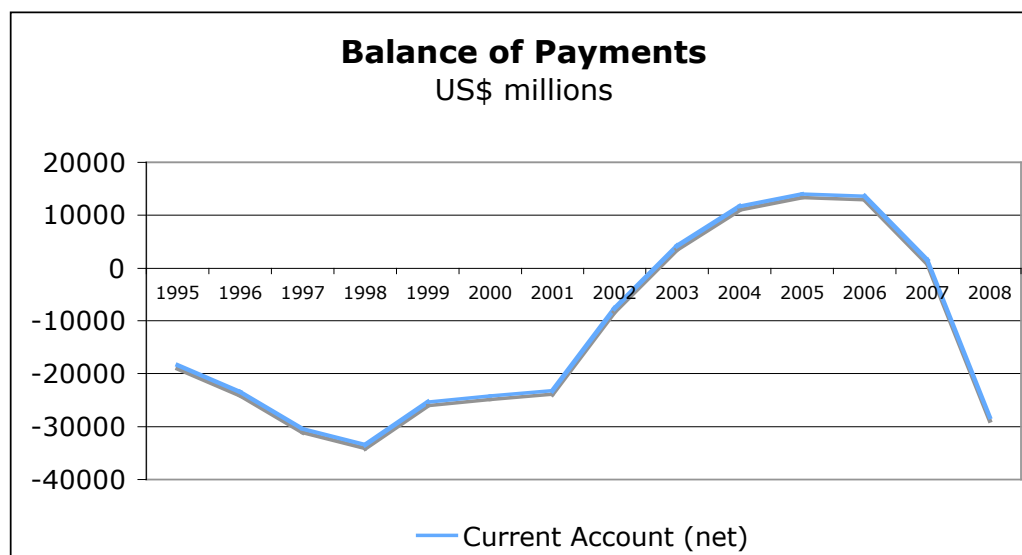


Figure 6: Brazil's Balance of Payments

Source: www.bcb.gov.br

This successful period was over in 2008. Brazil has not been spared from the global financial and economic crisis. Following nearly five years of surpluses, Brazil's current-account balance shifted into deficit in early 2008. Since the beginning of the global financial crisis, Brazil's currency and its stock market have significantly lost value, -41% for Bovespa for the year ending 30 December 2008.⁹¹

Domestic financial conditions tightened to a large extent and the supply of foreign credit to Brazilian enterprises, including exporters, dried up rapidly. The cost of domestic borrowing rose sharply, and the real depreciated by over 40% from the highs of mid-2008 through the end of the year.⁹²

⁹⁰ The World Factbook (2009), www.cia.gov

⁹¹ The World Factbook (2009), www.cia.gov

⁹² OECD (2009a), p.9

However, tensions were notably lower than those experienced by other large emerging-market economies. This was mainly because of the continued consolidation of macroeconomic adjustment in Brazil, which started with the new policy framework of 1999, combining inflation targeting, a floating exchange rate, rules-based fiscal policymaking and wise public-debt management. The country achieved a steadily falling inflation rate and public indebtedness and thereby reduced external vulnerabilities. This was an important requirement to increase the resistance to external shocks and to enable economic growth in the long run.⁹³

3.2.6 The present situation

With a total domestic market capitalization of almost 612 billion USD in January 2009, the BM&F Bovespa is ranked 13 of the world in this category.⁹⁴ In June 2009, 389 companies were listed, accounting for a market capitalization of 1.79 trillion BRL. 159 of those companies were listed in one of the special corporate governance levels, representing more than 70 percent of the total trading volume. Since February, the Bovespa Index has constantly risen. However, it is still far away from the historic maximum value in May 2008, but it is believed that Brazil is already rebounding from the crisis.⁹⁵

⁹³ OECD (2009a), p.9

⁹⁴ www.world-exchanges.org

⁹⁵ Busch (2009)

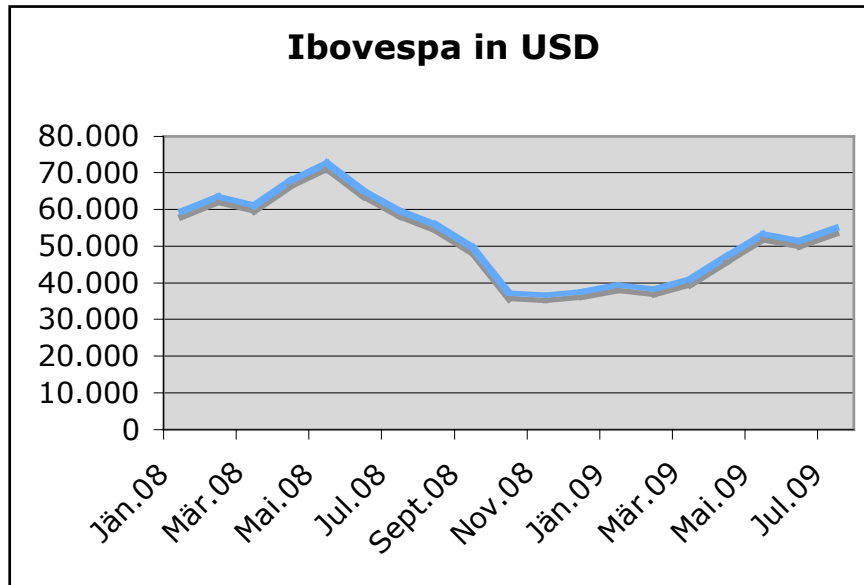


Figure 7: Bovespa Index in USD

Source: www.bovespa.com.br

The positive development is also shown by the first IPO that was realized after the crisis. At the end of June, Visanet went public and is now listed in the Novo Mercado segment. Also the Bank of Santander is going to join the São Paulo stock exchange this year.

The BM&F Bovespa made its way from an only domestically active, relatively unimportant stock exchange to one of the biggest exchanges of the world. It managed to get rid of the connection to Brazil's bad reputation and is now enjoying international acceptance and popularity.

Now, we will look at Russia, another interesting emerging economy with an important capital market. These two countries have some aspects in common but, as we will see, initial conditions were diverse and there seems to be no "one-size-fits-all" corporate governance. It cannot be consistently applied to a country with different structures and has to be adjusted to domestic conditions.

4 Russia and its economy

Russia is the world's fifth largest country in terms of geographic area and has a population of about 140 million people.⁹⁶

Poverty and the unemployment rate are declining steadily since more than ten years. The middle class is expanding. Russia's international financial position has also improved a lot, showing a positive balance of payments since 2000. In the last ten years, foreign exchange reserves increased by almost 588 USD billion. In 2008, the GDP growth was 6.0 percent, interrupting ten years of an average annual growth of 7 percent, which was achieved ever since the financial crisis of 1998.⁹⁷

Russia has made some process in improving the legal environment but corruption, lack of trust in institutions, exchange rate uncertainty and the global economic crisis still prevent a lot of investors from providing their money.

4.1 Corporate Governance in Russia

In the past decade, corporate governance has become a crucial issue for large Russian companies and the country as a whole. Once the government's privatization program began creating publicly owned stock companies in the early 1990s, corporate governance was needed to balance the interests of shareholders and opportunistic managers. However, seven decades of communism and central planning had provided as good as no experience in handling issues of ownership and shareholder rights.⁹⁸ Being a transition economy, Russia still had to do a lot of adjustments to become a full

⁹⁶ The World Factbook (2009), www.cia.gov

⁹⁷ The World Factbook (2009), www.cia.gov

⁹⁸ McCathy, Puffer and Shekshina (2004), p.398

participant in the global business economy of the 21st century.⁹⁹ The necessity of a good corporate governance existed since the early 1990s when the country began its development to a market economy, but no infrastructure had yet been created to support it. Even though some laws protecting the shareholders had been established in the late 1990s, abusing of the rights of minority shareholders and foreign investors was still a common happening.

In 2000, government officials and concerned business people realized the importance of trust of investors and therefore, standards of good corporate conduct. The OECD, the World Bank, the International Finance Corporation, the U.S. Commerce and State Departments and many other organizations have been encouraging Russian firms to adopt and implement corporate codes of conduct and good corporate governance principles.¹⁰⁰ Some progress had been made in the following years, but it was still not possible to accomplish Putin's goal to be a member of the World Trade Organization (WTO).¹⁰¹ Brazil, by contrast, already managed to be admitted in 1995. To achieve this, internationally accepted standards of corporate governance must be implemented, including disclosure and transparency, generally accepted accounting principles (GAAP), and a lot of other requirements concerning trade and commerce.

One problem that is characterizing the scene in the market is the fact that the state plays a dominant role in the ownership structures of Russian companies. Especially in large companies and banks, the state has strong equity positions and therefore a lot of influence. There is a systematic confusion between the government's function as an owner and a regulator. It tends to use its influence to support social and strategic objectives rather than to act in the interest of shareholder value maximization.¹⁰²

⁹⁹ McCathy, Puffer and Shekshina (2004), p.4

¹⁰⁰ McGee and Preobragenskaya (2004), p.1

¹⁰¹ McCathy, Puffer and Shekshina (2004), p.5

¹⁰² Shvyrkov (2008), p.3

Change in the Russian attitude regarding transparency and full disclosure is happening mostly because of the need for foreign capital. Foreign investors are not willing to invest in a company that does not disclose all the important financial information. Russian companies found they had to compete for capital in international financial markets and that was the impetus for change.

Russian companies were also put under pressure externally. For example, the New York Stock Exchange, one of Russia's main targets for foreign capital, has given nonresident companies two years to meet the demands of NYSE rules as a condition of having their stock listed on its exchange. One of its obligations is to have independent directors on the audit committee. This is an important factor an investor looks at when determining whether to invest in a Russian company or not. The company is much less attractive as a potential investment if those requirements are missing.¹⁰³

In April 2002, the Russian Institute of Directors (RID) issued the final version of its Corporate Governance Code, which contains a list of recommendations for best practices including some of the OECD.

4.2 The capital market

Since the transition from a centrally planned economy to a social market economy, the economic conditions and also the capital market in Russia changed significantly. Currently, Russia is characterized by high economic growth and increasing integration in the global markets. Many reforms have been implemented and the tax system is fair and transparent.

¹⁰³ McGee and Preobragenskaya (2004), p.5

4.2.1 Development

In the decades prior to the Russian Revolution, capital markets were strong and financed Russia's fast development and expansion to the east. Foreign and domestic investors controlled most of natural resources and industrial assets. But things changed when the new government took possession of Russian assets in 1917. Russia was absent from the worldwide capital markets for a long period.¹⁰⁴

Finally, in the 1990s, new publicly owned stock companies enabled the return to the global capital markets. The pre-revolutionary status was within reach and the large publicly traded companies attracted the interest of foreign investors once again. Passing more than 70 years basically without development in institutional rights and law, Russian securities regulators had to make up the leeway to meet the demands of the Western capital markets.

In 1998, the Russian capital market faced many problems. The value of the stock market was destroyed and trading went down to almost zero. The reason for this crisis was primarily, like in Brazil, the economic consequences of the Asia Crisis in that year. Falling energy prices hurt even Russia's biggest companies.¹⁰⁵ But the state was able to recover from the insolvency thanks to the good development of commodity markets.¹⁰⁶

4.2.2 The main players

Today, most of the stock trading in Russia is organized through The Moscow Interbank Currency Exchange (MICEX) and the Russian Trading System (RTS). Both of them are situated in Moscow, the financial and economic center of Russia.

¹⁰⁴ Goetzmann, Ukhov and Spiegel (2002), pp.7

¹⁰⁵ Goetzmann, Ukhov and Spiegel (2002), p.10

¹⁰⁶ Beck (2009), p.24

In the context of this exposition, the focus will be given on the MICEX, since its stock exchange is bigger than the one of RTS and therefore the most important of Russia.¹⁰⁷

4.3 The MICEX Stock Exchange

The MICEX Stock Exchange is part of the **Moscow Interbank Currency Exchange Group** and is in the top 30 list of leading stock exchanges of the world. With a total trading volume of shares in 2008 of USD 1985.6 billion¹⁰⁸, it is Russia's leading stock exchange. It accounts for over 98 percent of the total volume of equities trading on all Russian stock exchanges and over 70 percent of the global on-exchange volume of Russian securities trading. Trading is organized in the electronic form on the base of the modern trading system, which is connected to regional trading areas and remote terminals.¹⁰⁹

The MICEX Stock Exchange plays an essential role in helping carry out IPOs for Russian issuers. In 2007, 19 companies placed their shares on the exchange and raised a total of 26 billion US dollars. This makes the MICEX Stock Exchange one of the world's five largest exchanges.

Key indicator of the Russian stock market is the MICEX Index. Calculated in 1997, it is one of the oldest Russian stock indices. The MICEX Index is a capital-weighted price index of the 30 most important and most liquid shares traded at the MICEX Stock Exchange.

¹⁰⁷ (More information about RTS available at: <http://www.rts.ru/en/>)

¹⁰⁸ <http://www.micex.com/infocenter/presscenter/features/view/124706>

¹⁰⁹ <http://www.micex.com/group/profile/portrait>

4.3.1 History

When the Bank of Russia and leading commercial banks founded MICEX in 1992, an important step was taken towards the formation of the infrastructure of the Russian financial market. The MICEX group contributed a significant part to the process of establishment of the Russian market economy.

The short history of the MICEX Stock Exchange began in March 1997, when the first stocks were traded. By the end of the first year it had already 50 stocks from 33 different companies. In 1998, it suffered from the financial crisis but the game changed rapidly as Russian investors, above all banks, began joyfully investing their money in Russian stocks which were the only security with positive real returns for most of the last ten years. Two years later, 122 issuers had 174 stocks listed on the MICEX Stock Exchange.

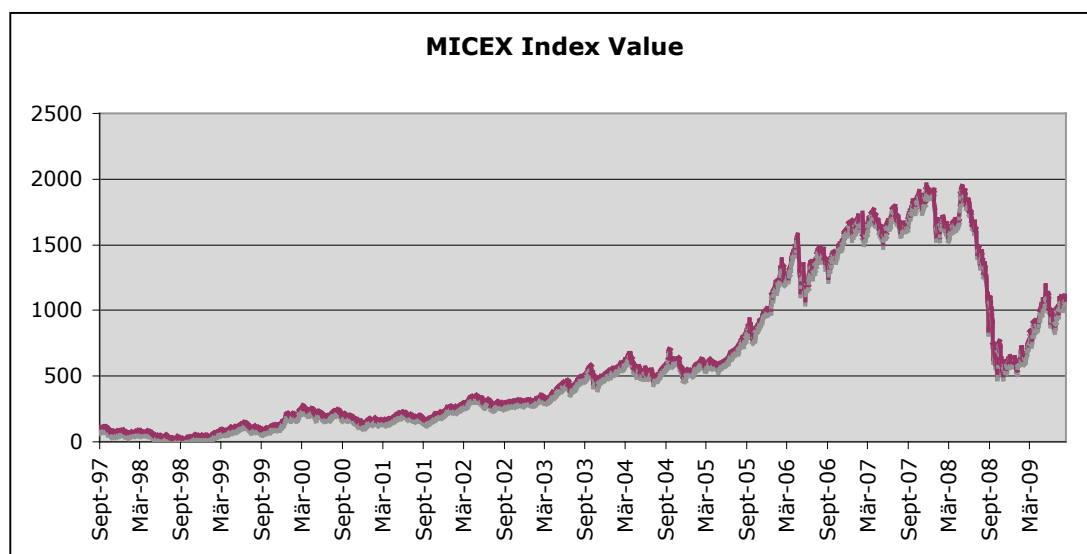


Figure 8: MICEX Index Value

Source: www.micex.com

Moscow's unique selling proposition is its geographical location: through the big range of time zones its traders can play the markets of New York, London, Singapore and Hong Kong all on one day.¹¹⁰

¹¹⁰ Aris (2008), p.2

4.3.2 Listing requirements

Issuers that want to trade their securities in the MICEX Stock Exchange have the options to go, or not to go through a listing procedure. If the latter option is chosen, securities are included on the Non-Listed Securities Schedule. This is the easiest and quickest way to start trading on the stock market since only a minimum of preliminary effort is required and no fees are charged.¹¹¹

If the issuer decides to do it through the other way, he has to choose between five different quotations, which vary according to their requirements. An overview about the differences is given in the following table.

Requirements	A1	A2	B	V ¹¹²	I ^{112,113}
Shares					
Common stock ratio of an individual and his affiliates (max)	75%	75%	90%	-	-
Capitalization of shares, rubles (min)					
ordinary	10bil	3 bil	1,5 bil	-	60mil
privileged	3bil	1 bil	500mil	-	25mil
Financial accounting	IAS / US GAAP	IAS / US GAAP	-	-	-
Corporate Conduct					
Board of independent directors	3	3	1	1	1
Auditing Committee	+	+	+	+	-
Obligation to disclose information about the issuer's holdings and securities transactions	+	+	+	+	+
Confirmation of document regarding usage of relevant internal information	+	+	+	+	+

Table 1: MICEX Listing requirements

Source: www.micex.com

¹¹¹ www.micex.com

¹¹² For capital issues, for the first time placed on the stock exchange through public subscription or over the counter

¹¹³ Availability of Authorized Financial Consultants

Quotation Lists V and I are intended for those securities placed for the first time by way of initial public offering at the stock exchange via a broker organizing the placement.

As can be seen in the table, quotations A1 and A2 have the strictest requirements. Only companies listed in that list are obligated to make their accounting after standards of US GAAP or IAS. Different to the Novo Mercado requirements, here in the highest level it is still allowed to issue 30 percent of the capital in form of preferred shares. This is impossible in Bovespa's highest listing. On the other hand, for List A1 and A2, it is obligated to have three independent members in the board of directors while in Brazil's special segments only one is needed.

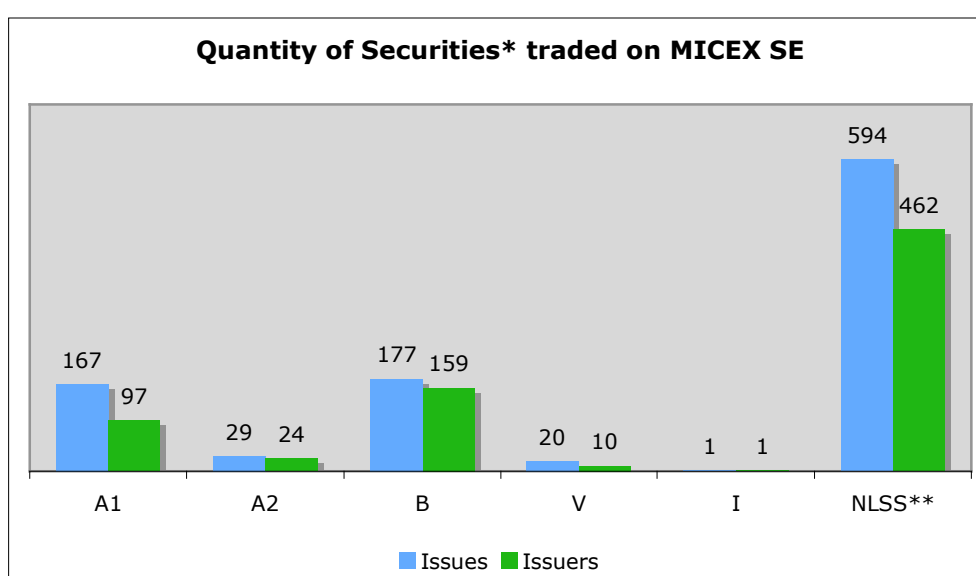


Figure 9: Quantity of securities traded on MICEX Stock Exchange¹¹⁴

Source: www.micex.com;

*Equities and Bonds, **Non-listed securities schedule

Figure 9 shows the quantities of securities traded on MICEX SE and their distribution within the different quotation lists. As can be seen, by far most of the companies offer their securities for trade without going through the listing

¹¹⁴ as of the 1st of July, 2009

procedure. By doing that they save not only time (10-20 days less), but also a lot of money since the inclusion on one of the quotation lists costs between 105,000 and 265,000 rubles. The most common quotation list chosen by companies going through the listing procedure is List B, where only one independent director is required and accounting does not have to be done by IAS or US Gaap standards.

4.3.3 Recent development

Recently, the Russian stock market was suffering from investor concerns over the Russia-Georgia conflict, corporate governance issues, and the global economic crisis, resulting in a fall of almost 70 percent. Also Russia's banking system suffered from liquidity problems and needed financial help from the State.¹¹⁵ It was and still is a challenge for policy-makers to manage the consequences of the economic recession and limit its severity and duration.¹¹⁶



Figure 10: MICEX Index Value in the crisis

Source: www.micex.com

¹¹⁵ The World Factbook (2009), www.cia.gov

¹¹⁶ OECD (2009b), p. 19

The negative financial trends in 2008 were a test for the governance mechanisms of many corporations. The remaining weaknesses in legal and regulatory infrastructure were highlighted once more.¹¹⁷ But, looking at the trend of the MICEX Index, it seems that the toughest time is already left behind. Since the beginning of the year, Russia's leading index already increased by more than 75 percent.

However, there is still a lot of improvement to do not only in the capital market but also in the Russian economy as a whole. The country has a short history in separating ownership from management. Introducing professional management structures and effective governance mechanisms is difficult but getting more popular.¹¹⁸ Russia is also still tailing the effectiveness of the regulatory infrastructure of most of the BRIC countries (Brazil, Russia, India, China). Only 24 out of more than 300 public companies are affected by the governance regulation. In Brazil on the other hand, about 25 percent of the top-listed companies are directly affected.¹¹⁹ The federal Service for Securities Markets (FSFM) has the core regulatory function. It recommended the Corporate Governance Code to all public companies. Still, because of the voluntary nature, the influence is quite little. Transparency, for example, is improving but the movement towards internationally accepted, obligatory accounting standards like IFRS or U.S. GAAP is much slower than in Brazil or India. It is only seen in very large companies who use it to improve their access to capital.

The limited role of financial markets and extensive government participation in equity of large firms remain a major barrier on the road towards economic stability and international leadership.

Even though the Russian stock exchange is much bigger than the Brazilian one in terms of volume of traded shares (see Table 2), it is still weaker and

¹¹⁷ Shvyrkov (2008), p. 2

¹¹⁸ Shvyrkov (2008), p.3

¹¹⁹ Shvyrkov (2008), p.10

more vulnerable in times of crisis. In the following part we will compare their development during the last years and analyze their possibilities of improvement.

5 Comparing the Brazilian and the Russian capital market

By now, we have heard a lot about the Brazilian and the Russian capital market, their history, development, and corporate governance. What is now of interest is to look at the differences and similarities between them to analyze the possibility of improvement regarding their corporate behavior and, as a consequence, their efficiency and international success. Even though both of them are emerging economies and they have some economic aspects in common, the basic beliefs and initial conditions are quite different.

Brazil made the business case implementing a new governance system into the stock market in a country where the legal regulations do not really offer the best conditions to attract foreign investors. It came up with the innovative idea to implement their own system and its efforts showed success. After some initial difficulties the system was accepted and companies started to voluntarily obligate themselves to higher corporate governance standards. The benefits coming along with them attracted more and more firms. Thanks to the Novo Mercado, Brazil's stock exchange managed to sustain its position within international capital markets.

The question now is if the same idea would also work out in the Russian capital market? Would the implementation of a “новые рынки”¹²⁰ create the same positive progress?

Some corporate governance improvement has already been achieved but the corporate responsibility has not quite reached the level of Brazil. Probably because of Russia's short history as a market economy, making a change in its business mentality appears a big challenge. The country has not had the same time as other emerging economies to develop its marketability and to make similar experiences to learn from. If the MICEX would implement a new, stricter corporate governance listing system, it would probably encounter

¹²⁰ (New Market)

resistance of several stock exchange giants that fear the need of cost-intensive changes.

Whether an innovation like the Novo Mercado would be prosperous in Russia is a hard question to answer. Before trying so, let's have a look at what distinguishes BM&F Bovespa and MICEX Stock Exchange from each other.

5.1 International comparison

Looking at their position in the international capital market, both of the two stock exchanges are within the top 20 worldwide in terms of volume of shares traded.

Stock Exchange	Volume of traded Stocks, USD mil	Stock Exchange	Volume of traded Stocks, USD mil
NASDAQ OMX	36.446.548,5	Hong Kong Exchanges	1.629.782,3
NYSE Euronext (US)	33.638.937,0	SIX Swiss Exchange	1.500.366,5
London SE	6.271.520,6	Borsa Italiana	1.499.456,5
Tokyo SE	5.607.321,9	Korea Exchange	1.432.479,9
Deutsche Börse	4.678.829,0	NASDAQ OMX Nordic Exchange	1.338.181,1
NYSE Euronext (Europe)	4.411.248,7	Shenzhen SE	1.248.721,8
Shanghai SE	2.600.208,6	Australian SE	1.213.239,6
BME Spanish Exchanges	2.410.721,2	Taiwan SE Corp.	829.612,2
MICEX	1.985.600,0	National Stock Exchange India	725.398,7
TSX Group	1.716.228,0	BM&FBOVESPA	724.199,2

Table 2: Top 20 Stock Exchanges worldwide¹²¹

Source: www.world-exchanges.org

Apart from that, both of them are the most successful in their region and rapidly climbed the ladder of development regarding their infrastructure and

¹²¹ as of July 2009

competitive position. Among the emerging countries, together with India and China, they are the biggest and fastest growing economies accounting already for 15 percent of the world's GDP and 40 percent of the world's population – upward trend.

In the following points we will look at interesting aspects that could be related to their corporate governance and its development. Let's start with their present condition.

5.2 Corporate Governance standards

Clearly, Bovespa is the winner when it comes to corporate governance standards used so far. Through the implementation of the new segments it could raise their standards significantly and made good corporal behavior a commonly expected condition within listed companies. Investors became more aware of their rights and expect corporations to act according to their code of conduct. Minority shareholders feel more secure and, as a consequence of having more rights, feel more invited to participate into the firm's activities. Thanks to the arbitration panel, help is provided if there should be a conflict. Issues concerning the capital market do not longer depend only on legal regulations. As a whole, the stock exchange is organized better and more effective and a lot more transparent then before the implementation.

In Russia, on the other hand, even though some progress has been made, there is still a lot of work to do. Preferred shares are still very frequent, leaving their shareholders with a worse condition compared to the owners of common shares. Further more, there is still not enough protection of minority shareholders. Also transparency standards cannot be compared to those of Brazil. It is not without reason that Russia is still not member of the WTO. However, the MICEX Stock Exchange showed initiative to improve the situation: in 2007, together with Interfax it launched a joint corporate

information disclosure project with the aim to expand the range of information services offered to market participants, to create better channels for the disclosure of information about listed companies and to improve the awareness of investors about IPOs.¹²²

In the same year, a new specialized exchange sector of innovative and growing companies (IGC) was launched to help small and medium-sized, fast growing innovation companies to attract investors and to create conditions that facilitate IPOs. This sector has stricter requirements concerning information disclosure. Companies in this sector have to disclose detailed information about their economic activity and provide a corporate calendar showing dates of their main events.

5.3 Market concentration

An important aspect differentiating the MICEX Stock Exchange from its Brazilian competitor is the high market concentration of its ten most traded domestic companies. The ten biggest blue chips, like Gazprom, Rostelecom or Rosneft, make up more than 90 percent of the whole market capitalization.¹²³ Companies of this dimension are very powerful and have a lot of influence into the economic happening. For this reason it is difficult to implement new systems if those companies won't agree.

Bovespa's top ten companies, on the contrary, only contribute half of the market capitalization. Therefore, power is not that concentrated and getting a lot of small companies to change their standards can convince others to come along because of their need to stay competitive.

Firms of the size and importance like on the Russian stock exchange do not have a lot to fear because they are market leaders anyways. Apart from that, their power is closely connected to politics, which sometimes can also be a

¹²² <http://www.interfax.com/12/296007/press.aspx>

¹²³ www.micex.com

disadvantage as it was in the case of Yukos. Mikhail Khodorkovsky, CEO of Yukos, Russia's former largest oil producer, was invited to the Kremlin and publicly complained about corruption, abuse of authority and unfair tactics used by the public oil company Rosneft, which was Yukos' competitor and was said to have close connections to the Kremlin. A few months later he found himself in prison, officially because of defraudation of tax. Opinions about the real reason differ. Strangely enough, in 2005, Rosneft took over Yukos.¹²⁴ This is the best example for illustrating the Russian system of power. It is hard to understand and analyze the internal mechanisms as an outsider but apparently there is more behind it than meets the eye. The state has a lot of influence into the economy and especially the financial market. To implement new ideas, one has to convince also its opponents and the state. Otherwise there is little chance to make a difference.

5.4 Development

The initial conditions of Brazil's and Russia's capital markets varied a lot. Brazil was characterized through a high dependence of foreign investors while most of Russia's capital was provided domestically. Bovespa was forced to make a change after it suffered so much from the consequences of the Asian crisis. That is why it came up with the idea of Novo Mercado: it was the need of foreign capital and of better corporate governance demanded by investors that made it implement a new system.

Having the world's largest reserves of mineral and energy resources, Russia - on the other hand - didn't depend so much on external investments. Until now it didn't really feel the necessary to align itself to international standards. Its own rules and system seemed to be enough and worked out for Russia's companies as well as investors.

¹²⁴ www.corporateconflicts.com/archives-yukos.html

During the last six years, as can be seen in Figure 11, the two stock exchanges went through a similar development. Being an indicator not only for the performance of the stocks but also for the country's economy as a whole, one can read the chart like an economic history book. In 2004 the MICEX Index only grew by 4 percent per annum because of negative developments during the "Yukos crisis". A huge fall in the Yukos stock consequently influenced all Russian stock exchanges as well as their indices. Changes in the oil price had influences in exchanges worldwide.

The annual growth rate was rising after the drop in 2004 and then sharply dropped again in 2008, when the international financial crisis resulted in several exchange crashes all over the world. Both the positive and negative movements were especially intense in the Russian capital market. One possible explanation for this is the trend of high willingness of Russian investors to carry a risk. More risk is connected to higher possible gains. Therefore, in a successful or lucky period, the value rises a lot, while in problematic times the high risk may result in large falls or even crashes.

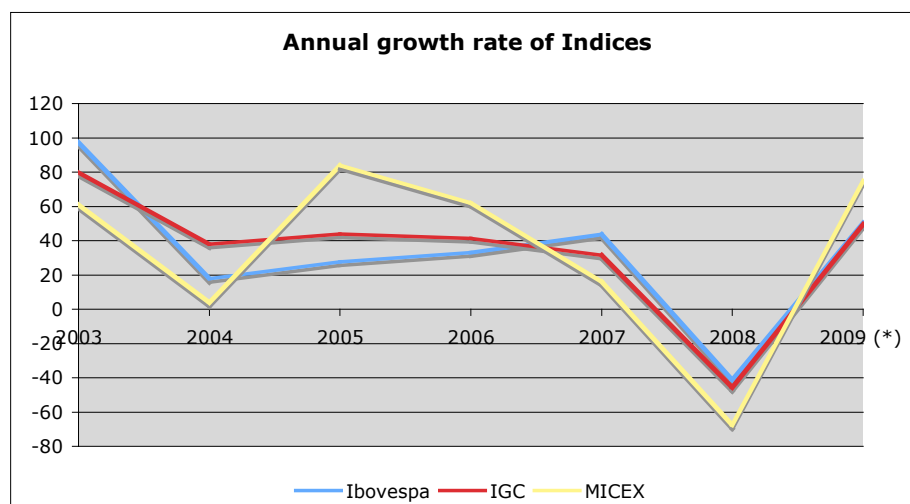


Figure 11: Annual growth rates of Indices; *until August 2009

Source: www.bovespa.com.br, www.micex.com

The index with the least average movements in value is the index of Bovespa's special segments, illustrated by the red line. From 2004 to 2007, it almost constantly rose by approximately 40 percent. Once again, it shows that

good corporate governance makes a company's stock less vulnerable to external influences. Stocks included in the IGC Index in average grow a little more steadily over time than those of the Ibovespa. After the drop in 2008 they developed about the same.

Figure 12 shows the number of initial public offerings of the last six years. After initial difficulties with the implementation of the new corporate governance system on Bovespa, the amount of IPOs increased rapidly from 2004 to 2007. MICEX couldn't keep up with the Brazilian stock exchange, neither in number of IPOs nor in the raised capital. Most of the IPOs issued on the Bovespa were realized in the Novo Mercado. Of course, it is hard to make assumptions about what would have happened without the implementation of the new segment, but probably the total amount of IPOs would be less. The new corporate governance system motivated companies to go public that without the system probably would have not. It offered them a good reputation to provide to their investors. The decisive argument was the higher attraction of new investors that are more willing to invest because of better conditions of transparency and protection.

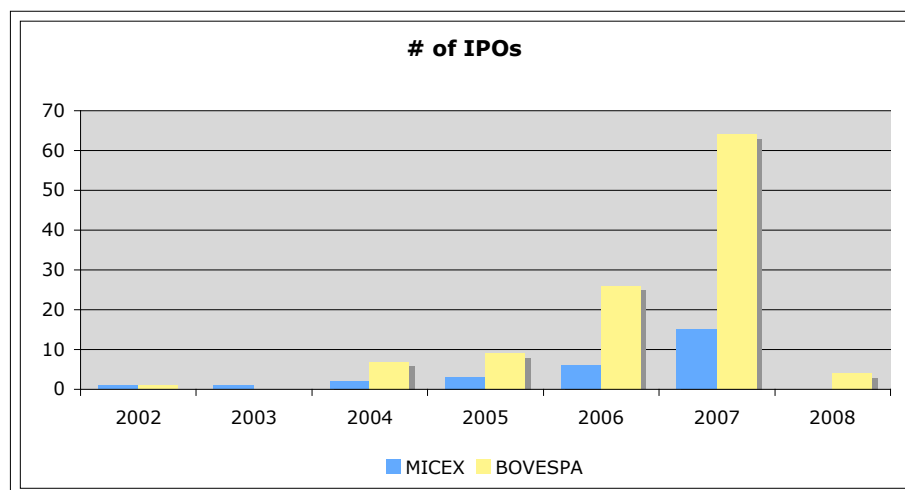


Figure 12: Number of IPOs realized on MICEX and Bovespa

Source: www.bovespa.com.br, www.micex.com

2006 was the only year when the volume of capital raised through IPOs of MICEX exceeded the amount of Bovespa, even though the number of IPOs was much lesser. This was achieved thanks to the huge public offering of

Rosneft with a total amount of almost 10,5 billion US dollars. On the Bovespa, for comparison, an IPO raises about 300 million US dollars on average.

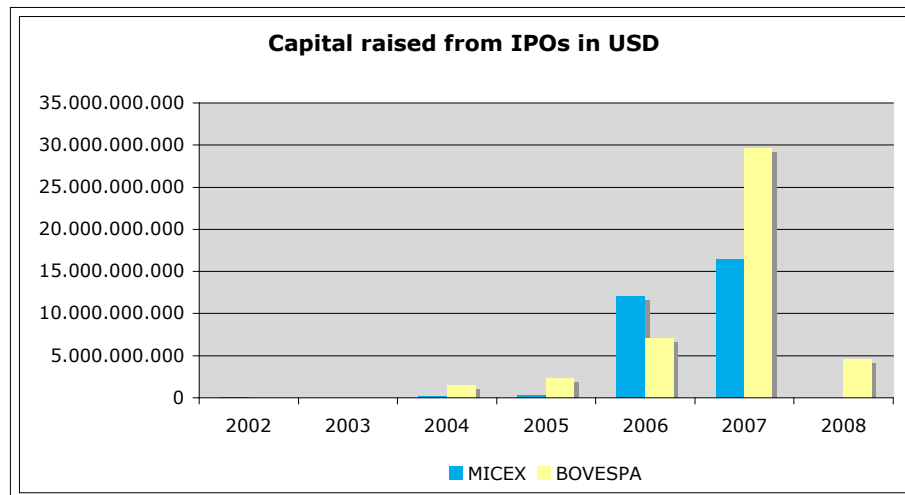


Figure 13: Volume of capital raised through IPOs
Source: www.bovespa.com.br, www.micex.com

In 2008, there was no IPO on MICEX Stock Exchange. However, it could raise about 2,4 billion US dollars from seven secondary public offerings (SPOs; also follow-on offering), which is the offering of shares by holders of registered stock to the open market.

5.5 Behavior during the crisis

The international financial crisis led to changes in the behavior of investors and companies. They were more cautious and less willing to take risks. But in Russia, it seems that investors already lost their fear. Rich Russians appear to be increasingly losing interest in Swiss bank accounts and dollar assets. Instead, they invest their rubles more in Russia itself, where all the risk, but also one's chances of winning are rated higher.

Maybe that is why the MICEX Index always has the most distinctive movements.

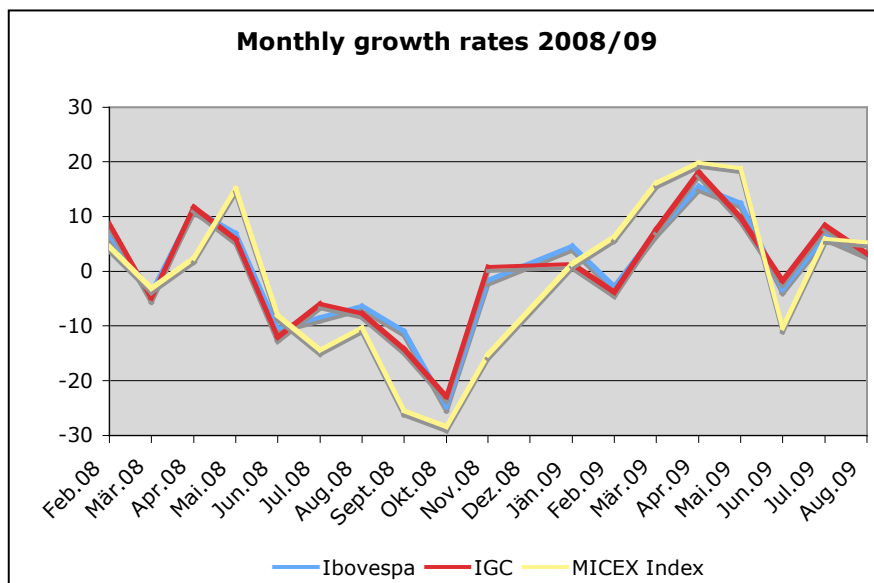


Figure 14: Monthly growth rates 2008/09

Source: www.bovespa.com.br, www.micex.com

Comparing the development of the Brazilian Index Ibovespa, the index of the special corporate governance segment IGC, and the MICEX index, one can clearly see that the Russian Index (illustrated by the yellow line) changed the most during the last one and a half years.

Depending highly on the oil price, Russia's economy was affected a little later than Brazil. Oil prices remained high until the second half of 2008 and then fell harshly, creating great pressure on the ruble and on public finances. From July 2008 to January 2009, the Russian stock index MICEX stock lost 58 percent and the ruble fell by 34 percent in value against the US dollar. But it seems that one year after the bankruptcy of U.S. investment bank Lehman Brothers, investors are willing to take risks again. Since the beginning of the year, the MICEX Index has risen by 87 percent, showing the fourth-best performance among the world's major stock exchanges. Also other stock exchanges in emerging markets recorded extreme profits: the Ibovespa has risen by 54.22 percent, Indonesia's Jakarta Composite even by almost 78 percent.¹²⁵ The two Brazilian indices had a similar development without significant differences, with the IGC averagely always running slightly above

¹²⁵ Financial Times Deutschland (2009)

the Ibovespa. Since the difference in the monthly growth rates is so small, it is not really possible to say if the higher corporate governance level was able to limit the damage of the crisis better to companies of one of the special segments.

5.6 Russian Novo Mercado?

Coming back to the central question whether the implementation of a “new market” like in Brazil would work out in the Russian stock exchange, my answer would be yes and no, it depends on the point of view. It needs differentiation to answer the question.

In a broader sense I would say yes, because I think that generally the idea of the concept works for every emerging but also developed country. The idea of improving the corporate governance situation is the background of many different policy reforms that were already implemented all over the world. The objective is to create a safer environment that guarantees the consideration of the interests of all relevant stakeholders.

But, on the other hand, this objective cannot be realized through the same mechanisms everywhere. That is why my answer is no from this side of view. Every country has its own, certain structures and official and unofficial rules determining the economic happening. This is especially true for Russia. There are certain, commonly known rules of “best practice”. Rules that concern the respect for powerful companies and people, like an unofficial list of “don’ts” that have to be respected in order not to be expelled from the scenario. I do not think that a Novo Mercado in Russia would show the same success like in its Latin American opponent. In Brazil, the implementation met with a lot of criticism. Companies were very skeptical and it needed a lot of time, patience, hard work and support from many influential institutions to convince market participants to step away from the traditional system. I think that procedure would be even more difficult in a country like Russia, where a few powerful

oligarchs set the tone in the business life. For example, only accepting common shares seems impossible in the Russian Stock Exchange, at least at the moment, because a huge amount of capital is held in preferred shares. Apart from that, it does not seem to me that they have the incentive to do it neither. I think many Russian minority shareholders do not even try to complain because they do not see the sense of their effort, assuming that it would not make a difference anyways. Improving the corporate governance has to be done through other reforms first. The probably most important change would be the establishment of an independent regulator. Implementing new rules does not make sense if there is no institution to control the application. Step by step it can then continue with other instruments like higher transparency requirements, especially for inter-corporate relations, and recognition of rights of stakeholders. Put it into other words, Russia needs its own version of a Novo Mercado to jointly create wealth, jobs, and the sustainability of successful corporations.

6 Future prospects and recommendations

For the future, I would say there is definitely a visible trend towards higher requirements in corporate governance, more regulations and a tighter network between shareholders, the management, employees and the society. The corporate social responsibility will be getting more important and companies will have to adjust their activities to the interest of all stakeholders.

I think Brazil is on a good way of getting there. Its rising awareness of the importance of good corporate governance will attract more and more foreign investors. This will further develop the country's infrastructure and let Brazil and the Bovespa climb the ladder of international capital markets until they can directly compete with developed economies. The Novo Mercado will be the new standard and corporations will realize that a listing in another segment is of disadvantage for them. Investors won't accept lower conditions any more because there are getting more confident and demanding concerning their rights and possibilities.

I believe that also the legal environment will improve. Of course it needs more time to change the law but various reforms will lead there step by step. I see a great potential not only in Brazil's capital markets but also for the country as a whole.

Russia's development, on the other hand, depends a lot on its further policy reforms. Being already an energy superpower, it has all the potential to become the most powerful economy of the world. But it must recognize that there is still a lot of work to do and that it lags behind other emerging economies when it comes to infrastructure, regulation, justice and transparency. If it wants to keep or even improve its international position, MICEX should strengthen its corporate governance and take demands of foreign investors into consideration.

If MICEX manages to implement higher corporate governance standards, the potential of improvement in its performance is enormous. It could attract

capital on a more international level. Right now, there are hardly any foreign companies listed. If the stock exchange would provide better conditions for companies and investors in terms of protection, regulation and transparency, than MICEX could raise its market capitalization and number of IPOs a lot. If it fails to do so, however, MICEX Stock Exchange would probably face a drop in its performance in the long run.

As mentioned before, I think another important aspect is MICEX's need to establish a regulator to settle corporate and stock market disputes like it was done in Brazil's Bovespa. Because of the bad legal environment, MICEX has to take care of conflicts itself. It has to guarantee to its stakeholders that a behavior according to the rules is being controlled, disputes being arbitrated and misbehavior sanctioned, especially in cases where the legal structure would fail to provide help. Concerning this, the MICEX already made a step into the right direction this year. Recently it signed a cooperation agreement with the Government of the Republic of Mordovia in order to develop the innovation and investment market at MICEX and to attract investments to innovative companies of Mordovia. Legal and informational–analytical assistance is provided to support the investors. There were also introduced proposals for improving the legislative environment for Russian innovative infrastructure development.¹²⁶

In general, I see two important challenges or opportunities of improvement for Russia: first, it should try to diversify its economy rather than rely on the energy sector. It wants to reduce its debt ratio by altering exports. But depending so much on the oil prices makes it weak during recession. Although there is a positive trend seen in the development of the oil price, one can never be sure what will happen in the future. It only needs one drastic event somewhere in the world to affect the price in Russia (like it was the case with the attack on the World Trade Center of Sept. 11th). And as we have seen many times, changes in the oil price also influence the market performance as a whole.

¹²⁶ www.micex.com

The second opportunity is also related to Russia's natural resources. Having such a huge amount of raw materials, Russia should use this advantage not only by exporting them but also by manufacturing products itself. To participate in more than just one stage of the supply chain could create a lot of added value for the country. Russia would probably have to contract foreign partners to obtain the necessary know-how and investments but establishing this multinational network could also be of great advantage for the economy.

It is essential to further develop the Russian capital market, because a consistent and highly capitalized financial infrastructure will enable the reduction of risk in Russia's economy. Like Alexey Rybnikov, CEO of the MICEX Stock Exchange, said: "*Turning Moscow into an international financial center is a big ambition, but a healthy and achievable one.*"¹²⁷

¹²⁷ www.micex.com

7 Summary and conclusion

Corporate governance has reached a new level of importance within capital markets all over the world. Several reforms have increased its awareness and have led to improvements in infrastructure, legal systems and transparency. But there is still a lot of effort to make to create a sustainable system of corporate governance. The financial crisis has shown that a lot of countries have to rethink their strategy and policy in order to be less vulnerable. It is not longer enough to only think about the maximization of economic value. The need of a long-run sustainability is getting bigger and, at the same time, creates a new factor of risk. Corporations have to consider the wealth of more than just one type of shareholders and have to take all possible outcomes of their action into account. The simple shareholder value concept is out of date and does not represent the objective of a modern company any more. It became inevitable to take the interest of other stakeholders into account when making decisions. The awareness of the right to be treated fairly has opened the mind of shareholders and led to a revolution in shareholder protection. Mechanisms to respond to the corporate responsibilities have to be created. Corporate governance is not only about dealing with the relationship between ownership and management anymore, it became crucial to defend one's position in the economic environment. It became part of the company's strategy, using it to reduce risk, improve its reputation and attract investors. Especially for emerging economies it is a good method to improve the conditions for starting to trade internationally.

Brazil's Bovespa realized the importance of good corporate behavior and found an innovative way to implement it into its system. Even though it had a difficult start, Bovespa managed to convince its market participants of the advantages of the Novo Mercado. It showed them that the high costs of issuing stocks in the new segment are a low price for what you get in the end: security, competitiveness, and the confidence that despite acting in a country of poverty and corruption there is a way to leave this image behind and to

keep up with developed economies. It gives companies the chance to compete on an international level. To make the structural changes easier, it established three listing segments that vary according to their degree of corporate governance requirements. Companies have the possibility to choose the level that matches the best with their intention and structural framework. Starting with the listing in the lowest level, companies do not have to adopt all changes at once but can still show their intention of improvement. Later on, whenever they feel ready for the next wave of changes, the firm can climb to the next level. By offering this possibility, Bovespa could improve its corporate governance standards gradually.

After a few years, initial difficulties were overcome and the amount of IPOs increased constantly, above all in the Novo Mercado level. The drop in performance last year wasn't as crucial as initially feared and Brazil was one of the first countries to leave the crisis behind, showing already a positive development in the last few months. It gained a lot of popularity thanks to the successful implementation of the Novo Mercado and is constantly climbing the ladder of prosperity.

Also the MICEX, Russia's most important stock exchange, started to make some effort in improving its corporate behavior. It also offers some different quotation lists to choose from to companies, who want to issue their shares. They vary in requirements but are still not comparable with the Brazilian ones. Preferred shares are still allowed even in the highest list and also transparency standards lie behind those of many other emerging economies. Russia being the world's number one producer of natural gas and oil¹²⁸, its stock exchange is led by energy blue chips like Gazprom or Rosneft, who boost the market capitalization to one of the ten biggest amounts worldwide. Being dependent on the activity of a few powerful oligarchs, it is not easy to implement new systems that might seem unnecessary to them. Their support is essential. MICEX already created two other segments that feature special requirements: the sector of innovative and growing companies (IGC) and the Market for Innovations and Investments. For companies who want to be active

¹²⁸ The World Factbook (2009), www.cia.gov

in one of them, corporate governance requirements, like the transparency standard, already exceed those of the traditional market. This is a good beginning. The next important step is to expand the higher standards to a wider range of segments. The more companies can be attracted, the more likely is it that also stock exchange giants adopt the new system. I think, like in Brazil, it would be helpful to have the support of some state institutions to convince them.

For me, the Brazilian as well as the Russian capital markets have the potential to be among the most interesting global investment themes if they develop according to the rising demands of corporate governance. They have the resources and preconditions to become leading economies within the next 50 years. Now it remains to be seen what the future holds and how these two countries will make use of their opportunities.

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ANHANG

Abstract

Im Laufe der letzten Jahrzehnte stieg das Interesse an Corporate Governance rasant an. In Kapitalmärkten weltweit ist das Thema rund um die Corporate Governance Mittelpunkt vieler Diskussionen geworden. Eine gute, verantwortungsvolle und zielgerichtete Führung von Unternehmen wird angestrebt und gefordert. Bilanzskandale in internationalen Unternehmen, Milliardendefizite amerikanischer Investitionsbanken in 2007 und 2008 und die Präsenz von exzessiven Managementgehältern haben viel Missvertrauen und Zweifel gegenüber der Organisation des Privatsektors hervorgerufen. Dadurch werden immer höhere Anforderungen an die Transparenz von Unternehmenshandlungen und die Rücksichtnahme von Aktionärsinteressen gestellt. Die größte Bedeutung hat diese Veränderung für börsennotierte Unternehmen. Vor allem in Schwellenländern wie Brasilien und Russland, wo es oft nur wenige Gesetze zum Schutz der Aktionäre gibt und das Rechtssystem tendenziell schwach entwickelt ist, ist eine gute Corporate Governance unverzichtbar geworden. Studien haben gezeigt, dass effiziente Corporate Governance einen wesentlichen Beitrag zur Stabilität am Finanzmarkt und zum Wirtschaftswachstum leistet.

Im Rahmen dieser Arbeit wird erst die Theorie der Corporate Governance behandelt und anschließend dessen Erscheinung innerhalb des brasilianischen und des russischen Kapitalmarktes analysiert. Die Entwicklungen der Börsen werden miteinander verglichen und deren Unterschiede und Gemeinsamkeiten heraus gearbeitet. Brasiliens Bovespa hat mit der Einführung seines Novo Mercados, einem speziellen Corporate Governance Segmentes, bewiesen, dass auch in einem Land mit einem schwachen Rechtssystem ein hoher Aktionärsschutz und hohe Transparenznormen geltend gemacht werden können. Brasilien zeigt damit, dass ein Schwellenland durchaus im internationalen Wettbewerb mithalten kann. Nun wirft sich aber die Frage auf, ob dieser innovative Ansatz auch in

Russland, einem Land geprägt von machtvollen, einflussreichen Oligarchen und einem hohen Grade an Korruption, erfolgreich eingeführt werden könnte? Um dies beantworten zu können muss differenziert werden. Die Idee, eine sicherere Umwelt für Aktionäre und andere relevante Akteure zu schaffen, ist immer und überall sinnvoll anwendbar. Allerdings kann das Konzept des Novo Mercado nicht universell angewendet werden sondern muss stets an die lokalen Gegebenheiten angepasst werden.

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