

LAVCA 2006
Summit

The Impact of Corporate Governance on Private Equity in Latin America

BELO HORIZONTE, BRAZIL
charles.bunce@cl.ey.com

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 **ERNST & YOUNG**

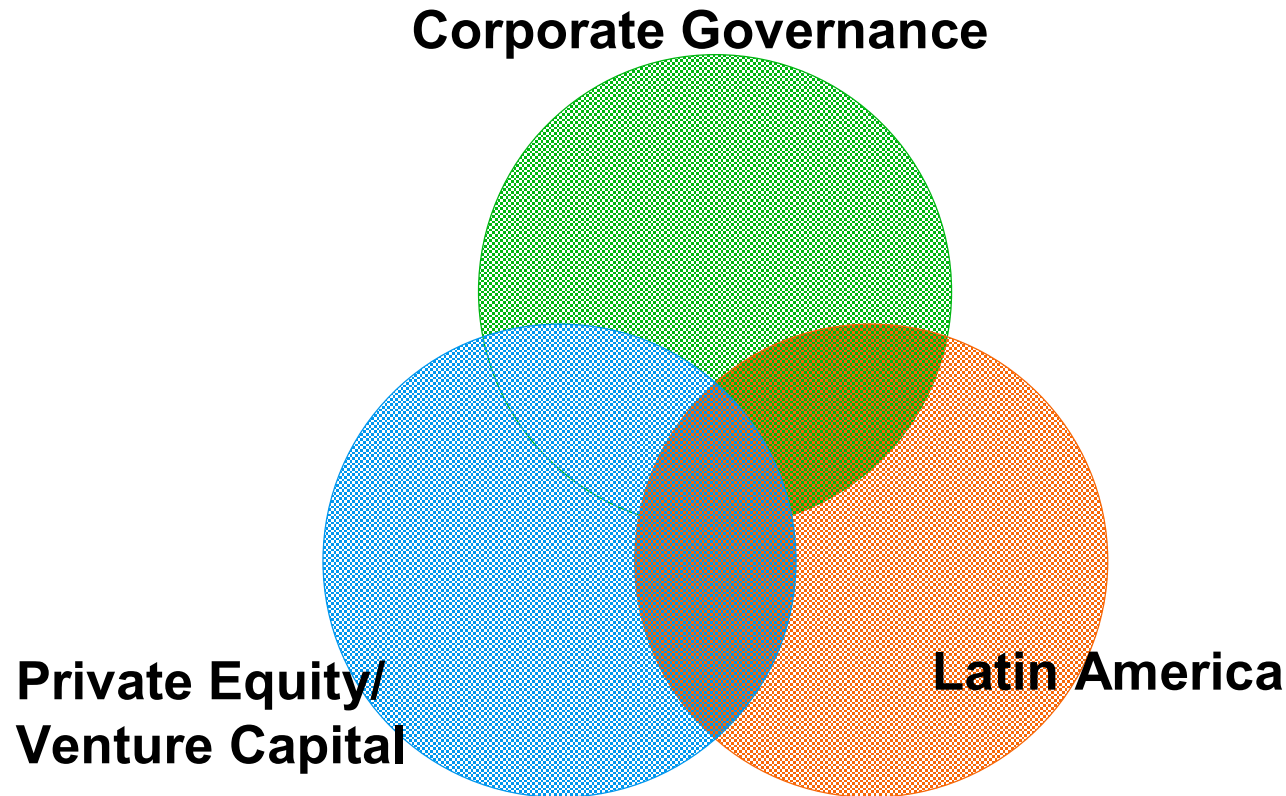
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"Frankly, I hate weekends. They break my momentum."

Corporate Governance, Venture Capital and Latin America



Agenda

- Introduction
- Corporate Governance
- Importance to Private Equity/Venture Capital
- Latin America: A Comparative Analysis



Corporate Governance Defined

“The relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.”

Source: Organisation for Economic Co-operation and Development:
White Paper on Corporate Governance in Latin America



Objective

- Protect and enhance shareholder value through:
 - Effective risk management
 - Accountability
 - Governance Structure
 - Reliable Information
 - Incentives & Control



Examples of Best Practice in Public Companies

		CORNERSTONE	BEST PRACTICE EXAMPLES
<div style="border: 1px solid black; padding: 5px; margin-bottom: 5px;">Board of Directors</div> <div style="border: 1px solid black; padding: 5px; margin-bottom: 5px;">Management</div> <div style="border: 1px solid black; padding: 5px;">Shareholders</div>		Effective Risk Management	<ul style="list-style-type: none"> • Whistle-blower mechanisms & Business Conduct Policies • Clearly identify company's risk profile
		Accountability	<ul style="list-style-type: none"> • Performance evaluations/reviews • Curb techniques that protect failing management teams • Strengthened shareholder oversight/monitoring through appointment non-executive chairman/coach
		Governance Structure	<ul style="list-style-type: none"> • Protection of shareholder rights / Independent board of directors • Board includes audit, compensation and corporate governance committees • "Tone At The Top"
		Reliable Information	<ul style="list-style-type: none"> • Management certification / External audit • Comparability / Use of international accounting standards • Focus on internal controls over financial reporting
		Incentives & Control	<ul style="list-style-type: none"> • Link management and board member compensation to performance • Effective internal audit function • Chief compliance officer

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“You’re not in material breach, but you’re not in full compliance, either.”

Importance to Private Equity/Venture Capital

The Private Equity Industry has changed:

- Increased demand to invest in private equity
- Unprecedented purchasing power
- Hedge fund and private equity convergence
- “Super-funds”
- Increased purchase price multiples
- Club deals



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“And, in a move sure to attract the attention of regulators, the private sector made a bid to acquire the public sector.”

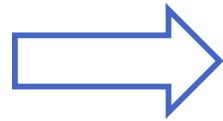
Corporate Governance and Private Equity

- How is corporate governance relevant to the private equity and venture capital enterprises?
 - Reputation
 - Exit strategy
 - Quality Information
 - Value Creation



Corporate Governance and Private Equity

**Solid Corporate
Governance
Strategy**



**Restrictions on
Management
Power**



**Higher
Shareholder
Returns**

Research demonstrates, albeit without strict causality, that the more management power is restricted in public companies (in favor of shareholders), the higher the market value of the company.

Source: 'Corporate Governance and Equity Prices' written jointly by Paul A. Gompers of Harvard Business School, with Joy Ishii and Andrew Metrick.



Private Equity: Finding Value through Corporate Governance

BUY SIDE

- More accurate determination of fair value
- Reduced transaction risk
- Reputational risk
- Reduce potential compliance costs

SELL SIDE

- Increased exit strategy options / flexibility
- Reduced potential impact on timing
- Closer investment monitoring
- Better information to make on-going / restructuring decisions

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“I, too, hate being a greedy bastard, but we have a responsibility to our shareholders.”

Latin America: A Comparative Analysis

- Diverse regulatory environment
- Ownership structures
- Available Resources
- Sarbanes-Oxley compliance
- The Enron effect





“I still don’t have all the answers, but I’m beginning to ask the right questions.”

Latin America: A Comparative Analysis

In general, do public companies have...?

	Argentina	Brazil	Chile	Andean Region	Mexico
Independent board of directors?	<input checked="" type="checkbox"/>		<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Separate roles of Chairman and CEO?			<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Alignment of management incentives?	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>			<input checked="" type="checkbox"/>
Board of directors including:					
Audit Committee	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Compensation Committee		<input checked="" type="checkbox"/>			<input checked="" type="checkbox"/>
Corporate Governance Committee		<input checked="" type="checkbox"/>		<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Shareholder communications that help understand the business, risk profile, financial condition and operating performance?	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Veto rights /Tender offer rules?	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Effective procedures communication between shareholders and board of directors?		<input checked="" type="checkbox"/>			
Has specific legislation been passed within the past 3 years with the intent of strengthening / mandating best practices on corporate governance?	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>

Overall

- Effective Corporate Governance is relevant to Latin America
- Regulation should foster good corporate governance practices, not impede them
- The role of the fund manager goes beyond financial reengineering
- A changed mindset will be critical in unlocking and maximizing value





“Now that you’ve all put in your two cents’ worth, I should like to interject my fifty-one per cent controlling interest.”



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