

## **Smelling the Coffee**

### **John Traynor TMF group**

In the final part of our series of features looking at how recession has affected economies around the world, John Traynor looks at how new developments in Latin America – particularly Brazil – could see it become a global leader.

As Frank Sinatra memorably sang, ‘they’ve got an awful lot of coffee in Brazil’.

The truth is they’ve got a lot more than coffee. In a world that hungers for commodities, Brazil’s vast deposits of oil and minerals such as iron ore, copper and bauxite, are attracting investors from as far apart as the US, the Middle East and China and fuelling the domestic economy. Could Brazil prove to be the powerhouse that catapults Latin America into the Premier League of developed economies?

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### **Latino heat**

The sheer diversity of Latin America’s economic and investment environment makes it particularly attractive to investors at present.

The largest economies of Latin America are Brazil, Mexico and Argentina, and Mexico and Brazil currently account for approximately 70 per cent of Latin American regional economic activity. Colombia, Chile and Peru have also attracted significant foreign direct investment in recent years – although other economies, such as Bolivia and Venezuela, look set on a different economic and political path at present.

One of the key drivers of growth in the region is down to the other main economic story of the last few years: the steady drift of the economic centre of the world eastwards and the growing global power of China.

China’s growth is also having a knock-on effect on economies such as Brazil. In 2009, Brazil has shown strong domestic IPO levels in comparison to the rest of the world, following the upgrade of its long-term foreign currency sovereign debt to investment-grade in spring 2008. This growth has been driven, at least in part, by a need for raw materials that has driven increased Chinese active investment in Latin America. Such investment is designed to achieve the guaranteed long-term supply of the raw materials the Chinese economy craves.

An example of this is the 13 trade agreements that were signed between China and Brazil in May 2009. Notable amongst these was a \$10 billion loan from China Development Bank to Brazil’s national oil major, Petrobras. Petrobras will, in return, supply a guaranteed amount of oil to China over the coming decade. It is possible that this Chinese engagement in the region is something which will, in turn, mean more economic and political engagement by the US with the region going forward – and this should mean even more economic benefits to Latin America as a whole.

Aside from a wealth of commodities, there are two other important factors making Latin America, and Brazil in particular, attractive to outside investors seeking above average returns. First, its close proximity to the US consumer economy is very

attractive, and particularly so in the case of Mexico (through its North American Free Trade Agreement (NAFTA) membership). The other factor is one of demographics. Latin America has a relatively youthful population base and, in Brazil, a growing middle class has seen a rise in domestic consumption. This has subsequently seen a growth in investment in the development of hotels, offices and shopping centres in recent years. Underpinning this is also a need for domestic infrastructure investment throughout the region. This will hopefully further open up economies to foreign investment, in order to facilitate these much needed capital expenditure projects.

It all sounds rosy: however, the Latin American economies have not been completely insulated from the economic downturn, despite hopeful initial theories of 'de-coupled' economies that would be sheltered from the financial storm hitting the financial markets of developed economies. For example, Mexico's reliance on trade with the US means that it has been hit harder than several other Latin American economies, as 80 per cent of its exports are to the US. Indeed, the UN Economic Commission for Latin America and the Caribbean (ECLAC) has predicted that exports from the region may decline by 11 per cent in 2009, the most drastic decline since 1937.

However, other commentators reckon that, if you take the region as a whole, this latest downturn may not be the most severe shock to hit the region's economies in recent years. For example, in 2002 Argentina's debt crisis saw its GDP shrink by 10 per cent with annual inflation of over 40 per cent, while Mexico's 1995 economic crisis saw a GDP reduction of over 6 per cent accompanied by inflation in excess of 50 per cent.

Government, non-governmental and private investor spending on the aforementioned infrastructure projects – including, in Brazil's case, upgrades to its ports, football stadia, high-speed train and airport network in readiness for the 2014 World Cup being staged in the country; increased investment in the lock system of the Panama Canal; and Colombian governmental encouragement of logistics and infrastructure improvements – may also provide needed stimuli, multiple economic benefits stretching into the future and attractive investment projects for global investors. Agriculture investment has also been an area of focus for investors, particularly in Argentina.

### **Land of opportunities**

The prominence of family-owned businesses in Latin America also presents opportunities for corporate secretaries in preparation for companies moving onto a public company footing in readiness for an IPO or other external investment.

The London Stock Exchange has been particularly successful in attracting mining companies from the region, and Brazil's domestic stock exchange, BM&F Bovespa, has also thrived. It may have even inspired the September 2009 announcement of the planned integration of the Chilean, Colombian and Peruvian stock exchanges to combine and create an integrated Andean stock exchange by the end of 2010.

However, due to its economic history and mainly civil-law based legal systems the region does have significant differences from subsidiary compliance regulations in other parts of the world. These can include foreign investment registry compliance, the requirement for local resident directors and legal representatives and an extra

compliance burden on the foreign shareholders themselves, in addition to more recognisable subsidiary compliance requirements.

Indeed, foreign shareholder compliance requirements can often be equal to the compliance burden of the foreign subsidiary entity itself. For example, in 2003 the equivalent of the Registrar of Companies in Buenos Aires (the Superintendency of Corporations or IGJ) introduced a number of controls on foreign companies carrying on business in Argentina. As a result, foreign companies that wish to become partners or shareholders of Argentine entities are required to register in advance with the IGJ and present evidence of existence, good standing and activities. This registration period can take up to two months, so adequate pre-subsiary incorporation planning should be in place. Following incorporation, in addition to the compliance requirements of the Argentine subsidiary itself, the foreign shareholders must also fulfill compliance requirements in Argentina, relating to legal representation, domiciliation and annual filing requirements.

Foreign investment registration and compliance requirements are also an imperative legal compliance task in Brazil and Mexico. These are filings that generally are not made to the Companies House equivalents, but with a specific and separate in-country authority, such as the Central Bank or foreign investment registry of the particular Latin American country.

In accordance with Mexico's Foreign Investment Law, each calendar year Mexican companies with foreign investors must register with the Foreign Investment Registry (RNIE) following incorporation and then file an Economic and Financial Report each year. They may also have to prepare and file a quarterly report of incomes, subject to revenue levels.

Meanwhile, a Brazilian company – typically incorporated as a limitada – which is in receipt of foreign investment, must register with the Brazilian Central Bank on incorporation. It is also required to make an annual update of its economic-financial data for the prior calendar year in the Central Bank of Brazil Information System (SISBACEN). It is important to note that there are many other bodies with whom the Brazilian entity must be registered and thereafter official compliance procedures to be followed. This is important, as such organisations may be asked to issue 'clearance certificates' regarding the Brazilian company from time to time, which may be useful in the course of business in Brazil.

Requirements under local corporate laws for the residency of directors or administrators and shareholder representatives are also a vital feature to be noted for company secretaries managing subsidiaries in the region. In Brazil, directors of a limitada are referred to as administrators, and have their powers prescribed in the articles of the company. The administrator must be resident and domiciled in Brazil. Importantly, the foreign shareholders of the company – in this case called quotaholders or partners – must also have a resident attorney in fact or legal representative in Brazil. This is a position of importance, as this person will have personal liability in the event of certain circumstances of non-compliance with applicable regulations in Brazil.

Residence of director and shareholder representatives is also a requirement in

Argentina, and should be closely monitored for compliance. The majority of the directors of an Argentine corporation must reside in Argentina and all the directors must maintain a special domicile in Argentina. Additionally, there is no provision in Argentina for single shareholder corporations, so if there are to be two shareholders of a company, care must be taken to ensure that the minority shareholder has a sufficient size of shareholding to meet the latest IGJ interpretations.

It should be noted that when entering into business or undergoing transactions, counterparties such as local businesses or governments will look at local registries to check the company's status, for example, extracting the Mercantile Folio from the Public Registry of Commerce in Mexico. Lack of clear compliance and correct statutory data can cause doubt and delays and therefore, as in other countries around the world, maintaining robust compliance on an ongoing basis is key.

### **Joint efforts**

Involvement in joint ventures (JV) in the region also requires care, especially in terms of corporate governance.

Investment in developing construction projects has increasingly been a highlight of private equity investment into Brazil. An important characteristic in much private equity and real estate investment in the region is that many global investors prefer to enter such new markets in conjunction with local expertise – for example in a joint venture with a local developer.

In order to protect the integrity of their investment and ensure robust corporate governance practices, outside investors can seek the comfort of appointing an independent third party to act in a corporate secretarial capacity. This can be particularly important where a majority of board seats may be held by the domestic developer. Ensuring a local independent presence, committed to ensuring all parties act in accordance with the articles of association, by-laws or JV agreement can be a vital protector of a significant value. This corporate governance control element is only set to become even more valuable, as US authorities increasingly focus on enforcing the US Foreign Corrupt Practices Act.

In these circumstances, having independent custody of the equivalent of the statutory registers and minute book – together with independent management accounting for such entities for US-based shareholders – can reassure foreign investors, as can the scheduling of a routine calendar of board meetings, the ensuring of proper notice for all directors of any unscheduled, ad hoc board meetings, proper controls over share transfers or any share issues that may have a dilution effect on existing shareholders and ensuring that good corporate governance practice is upheld in general.

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Brazil is currently the 'great story' for Latin American economic development. It is to be hoped that this will serve as both an inspiration and have an economic multiplier effect, fuelling growth throughout the region. Indeed, WPP Chief Executive Sir Martin Sorrell was asked this year by US interviewer Charlie Rose for his advice to young people currently growing up in developed economies on how to prepare for the changed economy of the future. Sir Martin replied that they should consider

starting to learn Portuguese, due to the projected growth of Brazil. When a business leader with the commercial savvy and global perspective of Sir Martin makes this suggestion, it is time for all of us to sit up, take notice and assess what these future and current developments mean for our businesses, clients and skills.

In the same way that global businesses are taking advantage of the opportunities presented by this emerging economic marketplace – perhaps echoing Sir Martin’s vision of the future global economic world – there are also significant opportunities in these emerging markets for the corporate governance skills that are a core part of the Chartered Secretary’s skill set. Indeed, in a world that may soon be dominated by these new markets, it is to be hoped that there are opportunities for Chartered Secretaries and their counterparts to branch out and promote corporate governance best practice across the world.

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