FIRST ANNUAL
SYMPOSIUM ON BUILDING THE FINANCIAL SYSTEM OF THE 21ST CENTURY: AN AGENDA FOR LATIN AMERICA AND THE UNITED STATES
HARVARD UNIVERSITY, CAMBRIDGE, MASSACHUSETTS • JUNE 13-15, 2008

Overview

Leaders from the public and private financial sectors of Latin America and the United States gathered from June 13-15, 2008 at Harvard Law School for the first annual Latin America-United States Symposium, organized by the Program on International Financial Systems. Three distinct issues of mutual interest to both regions were discussed by the attending participants.

Session I focused on the effect of corporate governance on the development of financial markets and the different rules associated with the varying ownership structures present in the two regions: the closely-held Latin American firm in contrast with the widely-held American public enterprise. Participants also discussed the different approaches to corporate governance that the U.S. and various Latin American countries have taken—approaches that run the gamut from a system of tight regulatory controls to a principles-based method of self-regulation.

Session II considered global financial stability in specific regard to the liquidity and credit crises in the U.S. While acknowledging the crises' limited direct impact on Latin America, participants agreed that the situation reveals the need for higher levels of disclosure and stronger regulation of structured credit products.

Finally, Session III provided an in-depth discussion on the development of private pools of capital in Latin America. Participants engaged in a comparative analysis with the purpose of assessing the relative roles and importance of private equity in Latin America and in the United States. There was consensus that, given underinvestment and scarcity of capital in Latin America, private equity will be key to industrial growth and financial development in the region. It was concluded, as well, that strengthening investor protection through tighter corporate governance standards and the creation of institutions that enable private capital investment will be required.

Session 1: Corporate Governance

A. Different Rules for Different Ownership Structures

Aware of the many different aspects involved in the topic of corporate governance, Symposium participants narrowed the scope of the discussion to evaluate specifically the role of corporate governance in the development of financial markets. They took into special consideration Latin America's current need to achieve market integration and build adequate financial systems.

Participants agreed that significant support for capital markets in Latin America exists. Using the U.S. as a historical model of financial development, they agreed that the establishment and implementation of corporate governance rules and institutions would be the first step in protecting market integrity, attracting investment, and making way for further stages of progress. These further stages of progress were defined among others, as deeper stock markets, market competition, and diffuse ownership.

Higher corporate governance standards and rules have recently been introduced to the securities regulations of select Latin American countries (i.e. fiduciary duties, minority protection rules, tender-offer legislation and tag-along rights for sale of control, increased representation of minority shareholders on boards and disclosure of material information, etc.). Such measures may initially send a signal of investor protection and attract capital. Despite the inclusion of such measures, however, participants voiced concern that the basic preconditions that serve as a foundation to a financial market appear to be absent in Latin America, namely: secure property rights and enforceability of contracts. This is particularly the case in a closely-held corporate environment where a tradition of family business and state-owned firms persists, and where strong dominant owners are more likely to extract private benefits of control. Consequently, participants agreed that although the law may provide for substantial investor and minority protection rules, if basic property and contractual rights are not in place, and without enforcement and the presence of a strong judicial system, the development of strong markets will be hindered. Concern was also voiced regarding the lack of widespread corporate governance expertise and knowledge in the region, including a problem of semantics where there is no clear consensus on the meaning of the term corporate governance itself. The lack of incentives for intermediaries and the lack of market information for analysts are further challenges mentioned.

Nevertheless, it was concluded that some corporate governance is better than none, and that establishing higher standards and implementing them through the different regulatory and self-regulatory approaches available should gradually lead to a culture of investor protection favorable for financial market consolidation. A number of participants were impressed with those owners of Latin American firms who have sacrificed the private benefits of control in exchange for corporate governance benefits (including better access to financing, cost of capital reduction, and visibility). This is not the case in all emerging economies, and seems to signal a positive evolution of the family-owned enterprise in Latin America.

Participants discussed the different rules and principles of corporate governance in their respective countries, taking into special consideration how their markets have been evolving. It was evident that such rules vary distinctly based on the ownership structures of both regions: the closely held/family-owned Latin American firm in contrast with the widely-held American public corporation. However, in advance of analyzing the aforementioned rules and approaches, it was argued by some participants that a particular type of ownership structure should not be considered a necessary precondition to the development of financial markets, and that a closely-held corporate structure is not necessarily negative. The proof tendered was that a capital market may successfully exist in an environment of closely-held firms. Indeed, this is the hallmark of private equity. In fact, practically all of the public firms of Latin America have strong controlling owners (including consolidated multinational organizations). It was nonetheless acknowledged that a financial system in its further stages of development, like that of the United States, is likely to give rise eventually to a widely-held corporate structure. This diffuse structure drives strong demand for investor protection by stock owners and thus, further accelerates widespread support for capital markets. An indicator of this tendency, as pointed out by a participant, is the fact that the São Paulo Stock Exchange (BOVESPA) now has several issuers that are considerably widely-held.

The session identified the following differences in corporate governance rules and principles as they are applied to the United States and Latin America:

Voting Rules and Proxy Advice

Participants emphasized the importance of a strong voting system in the development of financial markets, as this gives shareholders a more active role and boosts firm performance. It was also noted that, given the vast number of dispersed shareholders that compose the American public firm, voting acquires a more significant role, with active proxy advice taking place. In a typical Latin American firm, this is less likely due to majority ownership; instead, non-voting shares of public firms in the market are the common trend. Though important, it therefore appears that voting only comes into play in more developed financial systems of dispersed ownership. It was concluded however that less developed markets with closely-held environments need not wait until reaching advanced stages before improving access to the ballot via more detailed regulation and proxy advisors. Reference was made to Brazil's creation of an "only voting shares exchange" through the Novo Mercado segment of BOVESPA.

In light of agency costs, participants noted that interest in voting may be diminished in the United States. For example, a single shareholder may lack the incentives and resources to engage in voting, let alone monitoring management. Furthermore, shareholders seldom have a majority in the U.S. public firm, and participants stated that, with few exceptions, there comes a point where no single individual or concentrated group may have enough capital to control a large public enterprise; such is the current case in the United States.

However, in response to those views, the point was made that the definition of control differs significantly in both regions. In Latin America, a 51% majority is required, but in the United States, a much lower percentage (along the lines of 10%-20%) may be enough to exercise control. In addition, it was noted that institutional investors, rather than individual shareholders, often carry the burden of costs associated with voting. Institutional investors are playing a more active and significant role in closely-held Latin American firms, with the case of CEMEX (Cementos Mexicanos) offered as an example, a company that is now partially owned by institutional investors. As institutional investors become more active, these new players will likely have an impact in the voting process of firms from less financially-developed Latin American countries.

Independent Directors

The recent spate of corporate governance provisions related to independent directors in both U.S. and Latin American legislation was a topic of discussion. The importance of firm monitoring through independent directors was noted. It was also clearly acknowledged by those present that the role of directors in the two regions differs significantly. For example, as provided by law, the Board of Directors has a very significant oversight role, being the primary decision-making body in U.S. corporate structures *(Delaware General Corporation Law § 141. "… (a) The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors…"),* whereas in Latin America this board tends to have a more symbolic role. Instead, the General Shareholders Meeting (Asamblea de Accionistas) is the supreme governance body.

Participants were concerned about the fact that new legislation in Latin American countries requiring independent directors on the boards of public companies and financial institutions is not consistent with the reality of closely-held ownership. In addition, this legislation was considered excessive by some since it requires extremely high independent director quotas (i.e. 25%) that in many cases issuers are not able to meet. In fact, it was emphasized that "so-called" independent directors are often appointed by the controlling owners simply to comply with the legal requirement.

Since there are not enough independent directors to satisfy the legal requirements, in many cases the same directors hold seats on boards of different firms, which often creates conflicts of interest. Additionally, as a result of certain Latin American legislation incorporating fiduciary duties of loyalty and care, potential liability has also contributed to a deterrence of directors. Furthermore, the scarcity of independent directors has led to a professionalization of the role with university courses offering certification. Some participants voiced their disapproval of this trend, since they fear that the true nature of the independent director may be lost in this process.

Nevertheless, participants acknowledged that independent directors indeed play an important monitoring and advisory role in the corporate governance of an organization and that particular consideration should be taken in adjusting the role of the

independent director to Latin American business culture. Participants predicted that, as Latin American financial markets develop and gradually shift towards widely-held ownership structures, independent directors will become more relevant.

Minority Shareholder Protection, Tender Offer Rules and Tag-Along Rights

As a result of its closely-held corporate environment, minority shareholder protection has been weak in Latin American countries. Some participants argued that, given the extent to which closely-held small and medium-sized private firms represent an important sector of the Latin American economy, minority protection is not truly relevant. For example, a typical firm may have 99% of its shares in the hands of a sole controlling owner, with a second shareholder (often the spouse with 1%), included merely to comply with the legal requirement.

It was nonetheless acknowledged that increased minority shareholder rights, particularly in the public firm, would help build a stronger financial system. In fact, as financial markets have developed, securities and stock exchange laws have been concurrently incorporating enhanced minority protection rules. The tag-along rights recently included in Brazilian law were held up as an example. New rules on public offerings regarding tag-along rights have also been added to the Mexican Stock Exchange Law (Ley del Mercado de Valores de 2006). In the case of this legislation, if there is a sale of control, the buyer is forced to extend its offer to all the shareholders of the target company regardless of the type of share (this applies even to shares with limited or restricted voting rights or non-voting stock.)

Participants argued that the reason behind these tag-along rights was more to provide minority shareholder protection than to promote a more active environment of tender offers and takeover activity.

B. Different Approaches to Corporate Governance

To analyze the different approaches used by public firms in the U.S. and Latin America in the adoption of corporate governance standards, participants engaged in a comparative exercise involving the United States, México, Brazil, and Chile. Two broad categories were involved in the discussion: (1)the issue of regulation vs. self-regulation (a subject that includes the adoption of specific rules and principles, the use of real cost-benefit analysis when legislating, and the role of corporate governance advisory firms) and (2)the importance of enforcement in achieving sound corporate governance and financial market development.

Regulation v. Self Regulation

Opinions diverged widely on the subject of regulation. Some participants believed that voluntary adherence to standards is insufficient and that rules are required for good corporate governance. Others concluded that imposing mandatory provisions is not always the answer, given that ethical behavior in relation to corporate governance cannot be regulated. Along those lines, participants mentioned that the recent introduction of substantive corporate governance rules in Latin American countries has not always been a popular and effective approach. For example, it was mentioned that México has produced good corporate governance legislation, but that it has not been well accepted by firms and in many cases has backfired; firms follow a “check-the-box” approach simply to comply with the legal requirements. Additionally, there were comments about corporate governance rules not being popular in Panama.

The absence of real cost-benefit analysis in the process of corporate legislation was also discussed. Such analysis could reduce compliance costs and the burdens attendant upon corporate governance requirements (an example being the excessive costs of compliance related to the certification of internal controls in terms of Section 404 of the Sarbanes-Oxley Act of 2002). The lack of cost-benefit analysis and appropriate corporate governance culture makes regulation even less attractive. Participants highlighted a successful example of voluntary corporate governance adoption in the case of CEMEX, which through its “CEMEX WAY” policy standardized its global operations (including internal controls) before the turn of the century. Consequently, the wave of substantive corporate governance provisions that arrived after 2002 did not represent a significant burden to the company.

The point was strongly made that leadership from all parts of the finance community, and especially from its new players, can make a significant difference. Corresponding authorities (primarily securities commissions, central banks and ministries of finance); private enforcers (including intermediaries such as analysts, consultants and brokers); associations of share owners; accounting and law firms; and perhaps most importantly, corporate governance advisory firms (which, with the exception of Brazil, do not exist in Latin America) should all be called upon to provide this leadership. Additionally, participants made reference to the important role played by stock exchanges in Latin America, including, among others, the Brazilian Novo Mercado

and the Bolsa Mexicana de Valores, which has fostered the gradual transition of Mexican SAPI/SAPIB firms (Sociedad Anónima Promotora de Inversión/Bursátil) towards higher corporate standards and public markets. As pointed out, such leadership should be promoted to further a culture of corporate governance awareness in Latin America. Many participants believe that a self-regulatory approach should be tried first, and that future legislation on the subject would then be better received.

The most frequently mentioned example was that of Brazil, which, in contrast to México, Chile, and even to the U.S., was considered highly self-regulated by participants. Participants highlighted Brazil's reliance on principles rather than rules, another aspect that puts its corporate structure in sharp contrast with the aforementioned countries. Brazil was held up as a model to follow, with the Novo Mercado offered as an important paradigm of self-regulation (and one that is in direct opposition to the U.S. regulatory trend). Emphasis was placed on the successful self-regulatory and enforcement mechanisms that Novo Mercado has established without the need for regulators or legislators. It was generally agreed that such an environment allows a firm to adjust its corporate governance to its own particular stages of growth and development. It was also noted that this can promote equitable treatment towards minority shareholders and the loosening of the private benefits of control.

Enforcement and Financial Market Success

Due to the presence of important securities authorities from Latin America at the Symposium, the topic of enforcement received special attention throughout the weekend. Effective enforcement was proffered as perhaps the most important factor in ensuring investor protection, attracting capital from overseas, and contributing to the overall success of financial markets.

Many commented on the link between the accomplishments of the São Paulo Stock Exchange (BOVESPA) and the tighter financial enforcement recently exercised by the Brazilian Securities and Exchange Commission (CMV-Comissão de Valores Mobiliários), including unprecedented intervention in recent high-profile insider trading prosecution cases. With a new division and a special team devoted to enforcement, the CMV has adopted stricter procedures allowing more successful prosecutions. Current regulation also defines illegal practices and crimes more clearly. Nevertheless, as described in the previous section, participants agreed that Brazil's success has relied more on the promotion of a solid self-regulatory environment and a principles-based approach, rather than enforcement, which was actually considered by participants to be much lower than enforcement in Chile, México, and of course the United States.
Participants did however comment again upon the inefficacy of corporate governance provisions and minority protection rules in the absence of elemental property and contractual rights and adequate enforcement by the courts. Several participants wondered why, with similar rules, Mexican markets have not yet had the success that Brazil has recently enjoyed. This is especially surprising considering the competent teams of the Mexican Banking and Securities Commission (Comisión Nacional Bancaria y de Valores-CNBV). Some considered, however, that CNBV is an administrative body

constantly being deterred from enforcing its sanctions by the Judicial branch. The CNBV has been deterred from enforcing its sanctions given the unreasonable use of the judicial remedies available to the party being sanctioned, including the ability to seek redress before a constitutional trial known as “Amparo”. Others noted that, despite its role of ensuring investor protection, the enforcement a securities commission may provide does not solely guarantee the success of a stock market.

Finally, as with self-regulation, a group of participants believed that regardless of the presence of effective enforcement, legal provisions will only be popular and in turn contribute to the development of financial markets when a cultural awareness for corporate governance prevails.

Session 2: Global Financial Stability—The Impact and Control of the Liquidity and Credit Crises

Although Latin American participants were not overly concerned that the liquidity and credit crises would directly affect their respective countries, they were nonetheless eager to study the causes leading to the crises with the goal of preventing or predicting similar future problems.

A. Transparency and Disclosure

It was clear to all that the crises were borne out of an extremely risky market environment that was created through the combination of excess liquidity, lax lending policies, and complex liquid and structured credit products (i.e. asset-backed securities such as collateralized debt obligations – CDOs). In addition to those elements, the asymmetry of financial information—an absence of disclosure—was listed as a prevailing cause and one that precipitated a lack of confidence.

In addition to the lack of transparency, overconfidence on the part of investors was noted as one cause of the crises; participants referred here to a fundamental macroeconomic problem, namely the greed inherent in human nature. The innovative and complex financial tools (i.e. asset-backed securities, structured credit products, off-balance sheet vehicles etc.) that were created to sustain this system were very difficult for the public to understand given their intricacy. Participants believed there is a lesson to be learned: investors must acquire an awareness of true risk and be willing to shoulder hazard when necessary so long as there is an environment of adequate clarity and information available to them.

Overall, it was concluded that there should be more disclosure by issuers about their offerings. Participants also believed that investors should be more transparent regarding their holdings, and that banks should have to disclose their positions. Special focus was placed on the negligence of credit rating agencies and the lack of transparency in their methodology. Many believe such agencies have practically lost all credibility and that there is little use in further regulating them. They were compared more than once to the accountants and auditors involved in the 2001 corporate debacles. Participants agreed that less dependency on credit rating agencies should be the norm in the future.

It was agreed that disclosure about monetary policy by authorities, including the Federal Reserve and the U.S. Treasury, should also be increased, including more information on asset prices and inflation control, as well as on the liquidity to the different sectors of the economy.

B. Regulation

Although it was not clear to participants what specifically should be regulated as a result of the liquidity and credit crises, it was agreed that the pendulum will likely shift again towards regulation in the United States. Discussion focused on the temptation of the U.S. federal government to over-regulate the market, considering how it has reacted to crises in the past. The potential for rushed and excessive legislation, such as the wave that occurred in response to the 2001 corporate scandals with Sarbanes-Oxley, was a concern for participants. There was even concern that this potential legislative contagion could spread into Latin America. An alternate view was that such a phenomenon could be positive, as there are Latin American countries with little or no regulation on important subjects, including credit rating agencies. Brazil and Chile were singled out as countries that would benefit from further regulation as they move towards more advanced stages of financial growth and development.

Participants agreed that the preferred response to the crises would prominently involve increased disclosure. There was also agreement that asset-backed securities such as CDOs should be further regulated, rather than banned. Furthermore, though not very clear, other issues to be considered for regulation were capital, liquidity, lending activity, trader compensation and leverage restrictions.

On implementing regulation there were different viewpoints. One line of reasoning argued that regulation would be the only way to acquire transparency on asset-backed securities. Others differed, stating that the system is already too regulated, with the crises having derived from heavily regulated financial institutions (banks), and not from less regulated segments (i.e. hedge funds). Though they agreed that it is always possible to put forth a complex set of rules, a principles-based approach was suggested.

Others supported a self-regulation model, reference again being made to Brazil's Novo Mercado. They insisted that self-regulation and a principles-based policy promotes business ethics and educates investors, and is therefore the key approach to follow, with others adding that it all comes back to implementing good corporate governance.

C. Monetary Policy and Bailouts

Participants wondered whether loose monetary policy paved the way for the housing bubble. It was observed that the sharp reduction of interest rates by the U.S. Federal Reserve, among other actions taken, precipitated subprime lending. When the capital markets turned down, interest rates were lowered, allowing for the stock market to improve. However, this pushed investment bankers to creatively manufacture or find instruments that would provide for higher return rates, actions that led to the crises. The question arose as to whether the Fed should control asset prices and inflation.

Federal bailouts of banks was also discussed. Some argued that, given economic national interest, the U.S. will always have a safety net and will never allow important financial institutions to go bankrupt (the same was held to be true for many Latin American countries, with specific reference made to Brazil). Other participants questioned the value of rescuing banks, as intervention fosters irresponsibility on the part of both lenders and borrowers.

There was considerable criticism of the U.S. government for allowing the housing bubble to grow so large before letting it burst and for the government's lack of will to allow citizens to suffer losses when necessary. Participants also wondered how long the liquidity facilities extended to banks by the U.S. Federal Reserve will remain in place. Some believed these measures were necessary in order to avoid systemic risk, while others questioned the consequences should the measures become permanent.

The group agreed that, despite being painful, the government has to allow people to take losses as soon as possible and avoid postponing a potentially worse future explosion. Many participants suggested that only through a structure of rewards and punishments will borrowers become more conscious and responsible; they believe that responsibility should be shifted from lenders to borrowers.

D. Impact on Latin America

Participants concluded that the liquidity and credit crises will have a limited direct impact on Latin America. For one thing, Latin America has very modest holdings of U.S. securitized debt. In addition, the securitization of certain Latin American countries had higher underwriting standards and/or better aligned incentives. The consensus was that Latin America currently enjoys a positive economic scenario that will help the region to avoid the adverse effect of the crises. Latin American countries have good reserves and enjoy considerable capital from exports, among other positive indicators. In addition, the pension fund system has allowed higher levels of savings, even higher than in the United States. It was observed that some countries have a capital surplus in their balance of payments, with Chile mentioned specifically. The successful housing industry in México was also mentioned as a positive sign.

The specter of fallout from the crises, even in an indirect manner, troubled many participants, but it was acknowledged that this situation is part of an economic cycle that has also provided benefits in the past. Nevertheless, to guard against potential secondary effects, it was agreed that Latin American financial authorities should monitor secondary effects during the next two to three years.

Translating the consequences into real terms was of interest to participants. It was acknowledged that the downturn in the U.S. economy caused by subprime lending could affect trade, foreign investment and commodity prices. One of the most troubling potential consequences could be a reduction in imports to the U.S. from Latin America, although this effect could be mitigated by an important internal market that will likely

continue to be very active. The point was made that Latin America may also face financial difficulties regarding the prices of oil, food, iron, etc., and that a commodities bubble may burst at any time.

Participants agreed that, although the crises will have to be dealt with directly by the U.S. at a national level, some international cooperation and consultation might come into play, particularly from Europe, as it is the region most affected after the United States. It was agreed that Latin American intervention would be quite limited in solving the crises, but that the situation will serve as an important lesson to the global finance community.

Session 3: The Role of Private Pools of Capital in the Latin American/U.S. Capital Markets

A. A Comparative Analysis

The final session of the Symposium focused on the importance of private pools of capital in light of Latin America's current need for a more developed private equity market. Participants conducted a comparative analysis between the United States and Latin America, with special attention paid to the case of Brazil since it possesses the most active private equity market in Latin America. In order to give a fuller picture of the region, the cases of México (where apparently a very low rate of private equity activity exists) and Chile were also examined.

The differences between the role of private pools of capital in the United States and Latin America were discussed in this session. In the first place, it was recognized that the United States has, at least until recently, enjoyed high liquidity in addition to an important array of debt instruments which have encouraged fundraising and investment. Given the access to easy credit, it was noted that private equity funds in the United States have increased considerably in size, carrying out massive and highly leveraged deals. In contrast, there was widespread agreement that underinvestment (bottlenecks and fragmented sectors) has been the case in Latin America, due to a scarcity of capital and debt instruments.

Furthermore, it was observed that a large number of U.S. managers have pursued highly leveraged deals with private capital in an auction-driven market that promotes competition for transactions. Latin America, on the other hand, has fewer managers with the incentive to pursue private equity deals, and smaller, less-leveraged and privately negotiated arrangements prevail. Nevertheless, participants commented that, at least according to the Latin American model, private equity without leverage does seem to work well. In fact, it was added that leverage is no longer an essential element in the value creation process advanced by managers who have significant ownership stakes.

One distinction made between the two regions was that private equity in the U.S. does not usually create new industries but rather reallocates assets, while in Latin America, private capital investments usually result in the creation of new industry segments. The point was made that private equity firms in the U.S. seem primarily to invest in already consolidated industries, with new companies usually created out of venture capital. Venture capital firms also generally fund smaller projects, in contrast with the large investments funded by private equity mega funds.

Venture capital has not been very common in Latin America as it is associated with high risk; particularly absent appropriate property rights and contract enforceability. However, due to its emerging stage, Latin America has made a priority out of industry growth, and private equity is becoming an essential means to that goal given the scarcity in capital. Hence, under such a scenario, it would seem that a new conception

of private equity may be taking shape in Latin America, where private equity is starting to play a very similar role to that of venture capital.

In the U.S., value creation and improvement in the internal rate of return is generally accomplished by corporate restructuring, which paves the way for going private deals. In Latin America, however, firm value often results from investing in growth and business creation, a process more likely to involve taking firms public.

B. Are Private Pools of Capital Good for Latin America?

While analyzing the different environments of the two regions in relation to private pools of capital, participants considered whether it was advisable for Latin America to move towards the U.S. model before attaining a larger level of economic development. General consensus held that in relation to private equity, Latin America is still in an emerging state. However, some asserted that private capital in the region is essential for further investment in growth, the creation of value, and the development of new industries.

The multiple benefits of private pools of capital were outlined in the session. Such capital provides a necessary supplement to local banks, even when those banks are generally healthy and experiencing consistent growth. Private pools of capital also require less protection since they are composed of more qualified investors; this is likely to promote financial innovation. In addition, they may serve as an important means of reducing information asymmetries between capital market investors.

Although a number of issues need to be addressed to further enhance its private equity markets, it was agreed that Latin America appears to be in a good position to attract capital. Structural reforms, including privatization, considerable improvement in capital markets regulation, and higher corporate governance standards have all contributed to this favorable situation. Sounder macroeconomic policies have attracted foreign investment and have, in turn, led Latin American investors to the international market.

C. Some Restrictions

Although private equity investors have become very interested in Latin American business, and transactions in this market have increased significantly, it was observed that it has nonetheless been difficult to bring a significant number of transactions to a close, at least in certain parts of the region. While noting that there does seem to be enough capital for investment in Latin America, participants pointed to certain restrictions and obstacles that might be deterring investment. The concentrated ownership structure common to Latin American business was presented as one considerable limitation, as it results in low sale of companies. Such low level of sales also results from the buy and hold strategies often adopted by dominant institutional investors such as pension funds and insurance companies.

It was noted that investors will only proceed with a business opportunity if they are assured of profit in return. If faced with an environment of flimsy investor protection and property rights and where contractual enforcement is not in evidence, they will look elsewhere. It was observed further that these factors hinder public offerings of start-up firms since they deter both the venture capital firm and the entrepreneur from entering into the necessary agreements, regardless of the existence of investor protection rules.

D. A Series of Recommendations

In order to command the attention of private equity investors, it was agreed that investor protection in the region needs to be strengthened. This can be achieved through firmer corporate governance rules and the creation of institutions that enable investment, such as those that have contributed to Brazil's incredible growth rate.

Given the scarcity of capital for investment, it was suggested that financial markets in Latin America depend too much on banks and that a more complex set of instruments is required. It was also pointed out that access to the stock markets is limited to low-risk firms, which more often than not are the large consolidated enterprises that comprise Latin American public markets (firms with a much higher average market cap). There is a small number of listed firms, and IPOs seldom take place; according to participants, this scenario limits going-private transactions thereby inhibiting the use of private equity.

Participants differed on the question of whether more regulation is needed to develop the Latin American private equity market. Some participants noted that certain funds that invest in private equity, such as mutual funds, are heavily regulated in the U.S., and that a sound institutional and regulatory framework for capital markets is likewise required in Latin America. However, others argued that, despite concerns about unregulated market segments such as hedge funds, problems often arise from regulated markets and further regulation is not always the answer. These participants pointed to the recent liquidity and credit crises in the U.S. as an example. But on the other hand, that it is also necessary to reduce capital controls.

Finally, there was a great deal of discussion in relation to the small and medium sized firms (PYMES – Pequeñas y Medianas Empresas) that represent an important sector of the Latin America economy. These firms are currently hindered by a lack of access to capital and appropriate financing, which results from the absence of basic corporate governance standards. It was suggested that private pools of capital will likely play a very relevant role in activating this important segment of the Latin American market making way for further financial development.